Supreme Court, U.S.
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No. 96-

In the Supreme Court of the United States

OCTOBER TERM, 1996

VEREX ASSURANCE, INC., *Petitioner*

v.

NANCY ABSHIRE PALMA, *Respondent*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, consistent with *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), a federal court sitting in diversity may disregard state intermediate court decisions that are squarely on point and recognize a cause of action for a group of litigants never before countenanced under the law of that State.

2. Whether, at a minimum, the Court should grant the petition, vacate the judgment below, and either certify the state law question to the state supreme court or remand the case to the court of appeals for further consideration in light of an intervening state court decision that confirms that state law does not recognize the new cause of action created by the federal court.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

All parties are listed in the caption. The petitioner in this case is Verex Assurance, Inc., which is a wholly owned subsidiary of G.E. Capital Mortgage Corporation, which in turn is a subsidiary of General Electric Corporation.

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PETITION FOR A WRIT OF CERTIORARI

Verex Assurance, Inc. respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit (App., *infra*, 1a-24a) is reported at 79 F.3d 1453. The opinions of the magistrate judge (App., *infra*, 39a-59a, 62a-85a), which were adopted by the United States District Court for the Southern District of Texas (App., *infra*, 25a-26a, 37a-38a, 60a-61a), are unreported.

JURISDICTION

The court of appeals entered its judgment on April 16, 1996. App., *infra*, 1a. A timely petition for rehearing was denied on July 17, 1996 (App., *infra*, 87a-88a), and the petition for a writ of certiorari is accordingly due on October 15, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The Rules of Decision Act, 28 U.S.C. § 1652 (1988), provides:

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Article 21.21(16)[1] of the Texas Insurance Code provides in pertinent part:

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[1] In 1995, the relevant provisions of Article 21.21(16) were amended without substantive change. The decisions of the courts below address Article 21.21(16) as codified before those 1995 amendments, and thus this petition uses the statutory language employed in those decisions. The provision, as amended, is set forth in the Appendix at 112a.

> Any person who has sustained actual damages as a result of another's engaging in an act or practice declared in *Section 4 or in rules or regulations lawfully* adopted by the Board under this Article to be unfair methods of competition or unfair or deceptive acts or practices in the business of insurance or in any practice defined by Section 17.46 of the Business and Commerce Code as an unlawful trade practice may maintain an action against the person or persons engaging in such acts or practices.

STATEMENT

This case arises out of a charge by respondent Nancy Abshire Palma, a borrower, that petitioner Verex Assurance, Inc., a mortgage insurance company, violated Article 21.21(16) of the Texas Insurance Code when it sought to recover a mortgage loan deficiency following Palma's default. In pressing her claims, Palma invoked a provision in the mortgage insurance contract between petitioner and City Federal Savings & Loan ("City Federal"), Palma's lender — a contract to which Palma was not a party. Purporting to apply Texas law, the Fifth Circuit recognized a cause of action for an entirely new class of litigants, holding that borrowers are third-party beneficiaries of mortgage insurance contracts between lenders and their insurers and therefore have standing to bring an action under Article 21.21(16) of the Texas Insurance Code against insurers based on their handling of those contracts.

The Fifth Circuit's decision in this case, creating a new cause of action for litigants where none previously existed under state law, has aligned that circuit with one side of a split of authority in the Courts of Appeals concerning a federal diversity court's authority, under principles first enunciated in *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), to create new state law. The Fifth Circuit refused to apply the settled law of Texas, as established by consistent intermediate appellate court decisions, which plainly instructs that borrowers like Palma lack standing to bring claims under

Article 21.21(16) of the Texas Insurance Code against lenders' insurers.

The Fifth Circuit thus far has remained steadfast in its refusal to apply Texas law. Petitioner recently filed with the Fifth Circuit a Motion to Recall Mandate, a Second Petition for Panel Rehearing, and a Second Suggestion for Rehearing *En Banc*, informing the court of a subsequent Texas intermediate appellate court decision that plainly rejects the Fifth Circuit's view of Texas law. If the Fifth Circuit refuses to recall its mandate and conform its order to the state law of Texas, the court will be in violation of *Huddleston* v. *Dwyer*, 322 U.S. 232 (1944), and *Vandenbark* v. *Owens-Illinois Co.*, 311 U.S. 538 (1941). And as a consequence, the availability of a cause of action for borrowers under Texas law would depend solely — and improperly — on whether the plaintiff files suit in state or federal court.

A. Legal Framework

Article 21.21(16) of the Texas Insurance Code provides in relevant part that "[a]ny person who has sustained actual damages as a result of another's * * * unfair or deceptive acts or practices in the business of insurance * * * may maintain an action against the person * * * engaging in such acts or practices." Although "any person" would appear to provide standing to a wide range of litigants, Texas state courts construe the phrase quite narrowly. Indeed, Texas courts have recognized only three categories of plaintiffs who may bring an action under Article 21.21(16): the insured, intended third-party beneficiaries of the underlying contract, and persons who rely to their detriment on the words or deeds of the insurer. See, *e.g.*, *Shelton Ins. Agency* v. *St. Paul Mercury Ins. Co.*, 848 S.W.2d 739, 744 (Tex. Ct. App. 1993, writ denied); *Hermann Hosp.* v. *National Standard Ins. Co.*, 776 S.W.2d 249, 252 (Tex. Ct. App. 1989).

Texas courts have also addressed the specific question considered by the Fifth Circuit in the present case, *i.e.*,

whether a borrower has standing to sue the lender's insurer directly under Article 21.21(16) of the Insurance Code for claims arising from the lender's insurance contract, consistently and repeatedly holding that borrowers lack standing to bring such claims. See, *e.g.*, *First Am. Title Ins. Co.* v. *Willard*, No. 12-93-00290-CV, 1996 WL 495583 (Tex. Ct. App. Aug. 29, 1996)[2]; *Pineda* v. *PMI Mortgage Ins. Co.*, 843 S.W.2d 660, 673 (Tex. Ct. App. 1992); see also *Chaffin* v. *Transamerica Ins. Co.*, 731 S.W.2d 728, 732 (Tex. Ct. App. 1987) ("We are aware of no Texas case providing a statutory remedy for an injured third party against the insurance carrier of an insured."). This is because, as a matter of equally well-established Texas law, borrowers are neither named insureds nor third-party beneficiaries of the contracts between lenders and their insureds. See, *e.g.*, *Pineda*, 843 S.W.2d at 673; *Shields* v. *Atlantic Fin. Mortgage Corp.*, 799 S.W.2d 441, 442, 444 (Tex. Ct. App. 1990); see also *Chaffin*, 731 S.W.2d at 730-731 (homeowner neither insured nor third-party beneficiary of subcontractor's liability policy). This is true regardless of whether the borrower pays the mortgage insurance premiums, *Willard*, 1996 WL 495583, App., *infra*, at 98a; *Pineda*, 843 S.W.2d at 664, 673; *Hunt* v. *Jefferson Savs. & Loan Ass'n*, 756 S.W.2d 762, 765 (Tex. Ct. App. 1988), cert. denied, 489 U.S. 1079 (1989), or would benefit from the enforcement of the insurance contract, *Willard*, 1996 WL 495583 (App., *infra*, at 99a).

B. Proceedings Below

1. In 1983, Palma obtained a loan from City Federal to purchase a condominium. As a condition of the loan, Palma was required to fund an escrow account, from which City Federal purchased mortgage insurance from petitioner for

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[2] The opinion in *Willard* is reproduced in the Appendix. See App., *infra*, at 89a-111a.

protection against loss in the event Palma defaulted on the loan. App., *infra*, 1a.

In 1988, Palma defaulted on her obligation to repay the note, and City Federal foreclosed on the condominium. After foreclosure, there remained a balance due City Federal on the note. Petitioner paid City Federal the amount owing under the mortgage insurance contract, and City Federal assigned to petitioner the balance due on the loan after foreclosure. Petitioner then sent a letter to Palma demanding that the deficiency be paid. App., *infra*, 2a.

2. Rather than pay her debt, Palma filed suit in state court and sought certification for a class of borrowers, alleging numerous state law claims arising out of petitioner's pursuit of the deficiency. Palma's claims included an allegation that, by pursuing the deficiency, petitioner disregarded the terms of its mortgage insurance contract with City Federal and in so doing violated Article 21.21(16) of the Texas Insurance Code. Palma asserted that she had standing to raise the claim because she was a third-party beneficiary of the contract between petitioner and City Federal. App., *infra*, 2a-3a.

Petitioner removed the suit to the United States District Court for the Southern District of Texas and filed a counterclaim for the deficiency and attorneys fees. The case was referred to a magistrate judge (App., *infra*, 86a), who concluded that Palma was not a third-party beneficiary of the insurance contract between petitioner and City Federal and thus lacked standing to bring claims based on that underlying contract (*id.* at 67a-68a, see *id.* at 3a). The district court adopted the magistrate's memorandum and recommendations. *Id.* at 60a-61a; see *id.* at 3a.

Palma's remaining claim and petitioner's counterclaims were tried before the bench. App. *infra*, 3a. The district court entered a final judgment in favor of petitioner. *Id.* at 25a-26a.

3. By a divided vote, the court of appeals reversed, holding that Palma had standing to sue under Article 21.21(16) of the Texas Insurance Code. App., *infra*, 1a-24a. In the majority's view, Palma was a "third-party beneficiary of the contract for mortgage insurance entered into between [petitioner] and City Federal" (*id.* at 10a), and accordingly could bring an action against petitioner, the insurer, based on its handling of that contract. The majority acknowledged that a 1992 Texas intermediate appellate court had squarely rejected standing in virtually identical circumstances. *Id.* at 7a n.4 (citing *Pineda*, 843 S.W.2d at 665). Nevertheless, in light of *Allstate Ins. Co.* v. *Watson*, 876 S.W.2d 145 (Tex. 1994) — in which the Texas Supreme Court had *rejected* third-party standing under Article 21.21(16) — the court was "convinced" that the Texas Supreme Court would *find* standing in cases like this. App., *infra*, 7a n.4. In particular, the court identified three "factors" discussed in *Watson* that weighed against standing in that case, but favored standing here: (1) "Palma had a contract with the insured, City Federal"; (2) "Palma paid the premiums for the mortgage insurance"; and (3) "Palma is designated by name in the certificate of insurance issued by [petitioner] to City Federal." App., *infra*, 6a.[3]

Judge Davis dissented. App., *infra*, 22a-24a. He concluded that Palma lacked standing to assert the claims against petitioner because Palma "is not a third-party beneficiary" of the mortgage insurance contract and, among other things, "the Texas cases interpreting mortgage guaranty insurance policies unanimously hold that a borrower is not a party to such contracts." *Id.* at 24a.

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[3] The court of appeals reached this conclusion even while recognizing that the *Watson* court "did not expressly state that these factors were to be used when deciding whether a party was entitled to standing under [the Insurance Code]." App., *infra*, 6a.

4. The court of appeals thereafter denied rehearing, as well as rehearing *en banc*. App., *infra*, 87a-88a. Some 42 days after rehearing was denied, the Court of Appeals for the Twelfth District of Texas at Tyler decided an essentially identical issue of Texas law in *First American Title Insurance Co.* v. *Willard*, No. 12-93-00290-CV, 1996 WL 495583 (Aug. 29, 1996). App., *infra*, 89a-111a (reprinting *Willard* opinion). There, as in this case, a borrower sought to sue his lender's insurer under Article 21.21(16) based on the insurer's administration of an insurance contract between the lender and the insured. The Texas court, like every other Texas intermediate appellate court that had previously considered the issue[4] and unlike the Fifth Circuit, held that a borrower does not have standing to raise such claims. App., *infra*, 99a. The court reached this result even though Willard, like Palma, (1) had a contract with the insured and (2) had paid the premiums for the insurance policy. *Id.* at 98a-99a. (The *Willard* opinion does not state whether the plaintiff was designated by name in the certificate of insurance, although there would have to have been a reference to either Willard or the property to identify the risk for which the insurance was purchased.) The court cited *Watson* as authority for its decision denying standing. *Id.* at 98a.

The present case is on all fours with *Willard*, except as to result. In *Willard*, the court, relying on *Watson*, expressly held that a borrower did *not* have standing to bring a direct cause of action under Article 21.21(16) of the Insurance Code against its lender's insurer based on the insurer's handling of the lender's insurance contract. App. *infra*, 98a-99a. The Fifth Circuit — also citing *Watson* — concluded that a borrower *did* have standing to bring that same claim against its lender's insurer. See *id.* at 4a-10a.

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[4] *Pineda*, 843 S.W.2d at 673; *Chaffin*, 731 S.W.2d at 730-731; see *Shields*, 799 S.W.2d at 444; *Hunt*, 756 S.W.2d at 765.

6. When petitioner learned of *Willard*, it promptly called the decision to the attention of the Fifth Circuit by filing a Motion for Recall of Mandate, a Second Petition for Panel Rehearing, and a Second Suggestion for Rehearing *En Banc*. The motion and petitions are pending before the court.

REASONS FOR GRANTING THE PETITION

This case calls for the exercise of this Court's supervisory authority over the administration of federal diversity jurisdiction. The Fifth Circuit's decision presents the Court with an opportunity to resolve an important and recurring split among the Courts of Appeals regarding their authority under *Erie* to forge new state law.

If the Court elects not to use this case as the vehicle by which to address the schism among the federal appellate courts, the Court, at a minimum, should grant certiorari, vacate the judgment below, and either certify the state law question to the Texas Supreme Court or remand with instructions that the Fifth Circuit reconsider its decision in light of *Willard*. Court action is necessary here — just as it was in *Exxon Co., U.S.A.* v. *Banque de Paris et des Pay-Bas*, 488 U.S. 920 (1988), and *National Union Fire Ins. Co.* v. *American Medical International, Inc.*, 116 S. Ct. 510 (1995), two cases in which the Court ordered courts of appeals to reconsider their decisions in diversity cases in light of subsequent state court authority. See also *Huddleston* v. *Dwyer*, 322 U.S. 232 (1944); *Vandenbark* v. *Owens-Illinois Co.*, 311 U.S. 538 (1941). Court action is required in the present case to resolve the current intrastate conflict in Texas as a result of which the availability of a cause of action depends solely on whether the case is in state or federal court, in violation of *Fidelity Union Trust Co.* v. *Field*, 311 U.S. 169, 180 (1940).

I. A FEDERAL COURT SITTING IN DIVERSITY EXCEEDS ITS *ERIE* AUTHORITY WHEN IT CREATES STANDING FOR A CLASS OF LITIGANTS TO BRING CLAIMS, WHEN SUCH STANDING HAS BEEN REJECTED BY THE COURTS AND LEGISLATURE OF THE STATE.

A. The Courts Of Appeals Are Divided On The Important And Recurring Question Whether Federal Courts Can Make New State Law

This case presents the Court with an opportunity to resolve a persistent conflict among the federal courts of appeals by rejecting an unjustifiable — but widely invoked — interpretation of a federal court's authority under *Erie* to forge new state law. The question demands the Court's review as it concerns a fundamental issue with which federal courts sitting in diversity must contend on a daily basis.

Federal diversity courts must follow and apply state substantive law. *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938). Where there is no state law authority directly on point, the federal court must make an "*Erie* guess," predicting how the state supreme court would apply settled state law to a new factual situation. This type of interstitial decision making is the daily grist of the federal courts' mill.

The more problematic question posed by this petition arises when a federal court is asked not simply to apply settled state law to situations previously unconsidered by the state courts, but rather to make new state law. In such cases, may federal courts expand, modify, or revoke settled state law principles as a state supreme court might do? The answer to this question, which implicates fundamental issues about the proper role of federal courts in our federal system, differs depending on which court of appeals is being asked.

In this case, the Fifth Circuit recognized standing for Palma, a borrower, to bring a claim under Article 21.21(16)

of the Texas Insurance Code against petitioner, the lender's insurer, based on petitioner's handling of the mortgage insurance contract.[5] App. *infra*, 21a-22a. In so ruling, the Fifth Circuit essentially created a new cause of action for an entire class of litigants — a result all courts in Texas had previously rejected. See pp. 3-4, *supra*. In reaching its novel result, the Fifth Circuit explicitly disavowed the well-settled and heretofore unquestioned law in Texas that borrowers, as neither insureds nor beneficiaries, do not have standing to bring claims under Article 21.21(16) of the Insurance Code against the lenders' insurance companies. App., *infra*, at 7a n.4 (citing *Pineda*, 843 S.W.2d at 665). In at least five other circuits, Palma's innovative argument to overturn Texas' settled law of standing would not have been seriously entertained, much less adopted.

1. The rule in at least five circuits is that a federal court sitting in diversity may not make new state law. These courts hold that to usurp state lawmaking authority in this manner is inconsistent with principles of federal-state comity and the proper role of the federal courts as enunciated in *Erie*.

The First Circuit, for example, perceives its *Erie* role as applying state law, not making it.

> Absent some authoritative signal from the legislature or the [state courts], we see no basis for even considering the pros and cons of innovative theories * * *. We must apply the law of the forum as we infer it presently to be, not as it might come to be.

Dayton v. *Peck, Stow & Wilcox Co.*, 739 F.2d 690, 694 (1984) (footnoted omitted).

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[5] The reach of the majority's opinion may even be broader. If borrowers are held to be third-party beneficiaries of their lenders' insurance contracts, then borrowers may be able to bring numerous other statutory and common law claims against their lenders' insurers, as Palma attempted to do here. See App., *infra*, 42a.

The Third Circuit has explained the important notions of federalism that underlie this rule:

> In a diversity case * * * federal courts may not engage in judicial activism. Federalism concerns require that we permit state courts to decide whether and to what extent they will expand state common law * * *. Our role is to apply the current law of the appropriate jurisdiction, and leave it undisturbed.

City of Phila. v. *Lead Indus. Ass'n*, 994 F.2d 112, 123 (1993). Concerns of federalism — and responsible jurisprudence — also feature prominently in another Third Circuit opinion, which rejected an invitation to interpret a divided Pennsylvania Supreme Court decision as creating new state law:

> For a federal court to predict that a majority of a seven-judge court with three new members would overrule a long established doctrine of Pennsylvania law would be to engage in reckless speculation. If a change in the basic Pennsylvania tort law is to be forthcoming it should emerge from a majority of [the Pennsylvania supreme] court and not from the Court of Appeals for the Third Circuit.

Vargus v. *Pitman Mfg. Co.*, 675 F.2d 73, 76 (1982).

The D.C. Circuit likewise adheres to a policy of judicial restraint when sitting in diversity. In *American Institute of Architects* v. *Interstate Fire & Casualty Co.*, 986 F.2d 1455 (1993), for example, the court considered an invitation from the claimant, the AIA, to "follow the 'modern trend' of excusing any delay in the absence of prejudice" in determining whether, under Illinois law, the AIA had given timely notice of a claim to a fire and casualty insurer. A unanimous panel, including then-Judge Ginsburg, rejected the AIA's entreaty, stating succinctly that "[it] is not our place * * * to break new ground for the Illinois courts." *Id.* at 1458.

The Fourth and Seventh Circuits are in accord with the D.C. Circuit's understanding of a federal court's role under *Erie*. See, *e.g.*, *Burris Chem., Inc.* v. *USX Corp.*, 10 F.3d 243, 247 (4th Cir. 1993) ("Under *Erie Railroad* v. *Tompkins*, the federal courts sitting in diversity rule upon state law as it exists and do not surmise or suggest its expansion."); *Trembath* v. *St. Regis Paper Co.*, 753 F.2d 603, 605 (7th Cir. 1985) (noting that "the District Court properly refused to speculate that there might be a 'trend' in Wisconsin toward regulating unilateral pronouncements * * * as contractual obligations, or toward abrogation of the employment-at-will doctrine") (footnotes omitted).

2. By contrast, the Second, Sixth, Eighth, and Ninth Circuits have adopted a self-consciously more activist role in fashioning state law under *Erie*. According to the Second Circuit, for example, a federal court sitting in diversity is free to consider "all the resources that the [state's highest court] could use" in making the state law determination, including the State's "policies" and the law of other jurisdictions. *DeWeerth* v. *Baldinger*, 836 F.2d 103, 108 (1987), cert. denied, 486 U.S. 1056 (1988).

Like the Second Circuit, the Sixth Circuit takes an activist approach in making state law under its *Erie* authority. In *Johnson* v. *Honeywell Information Systems, Inc.*, 955 F.2d 409 (1992), for example, the Sixth Circuit anticipated that the Michigan Supreme Court would allow a defense to a claim of wrongful termination of employment based upon employee misconduct discovered after termination. The Court predicated its guess, in part, on "common sense" and "the dearth of Michigan case law to the contrary." *Id.* at 413.

Neither the Second nor the Sixth Circuit's creative approach would have been permitted in those federal circuits that will not "even consider[] the pros and cons of innovative theories," *Peck, Stow & Wilcox Co.*, 739 F.2d at 694 (1st Cir.), that decline "to decide whether and to what extent they will expand state common law," *Lead Indus. Ass'n*, 994 F.2d

at 123 (3d Cir.), that "refuse[] to speculate" on state law "'trend[s],'" *St. Regis Paper Co.*, 753 F.2d at 605 (7th Cir.), that "do not surmise or suggest [the] expansion" of state law, *Burris Chem., Inc.* 10 F.3d at 247 (4th Cir.), or that refuse "to break new ground" in areas of state law, *American Inst. of Architects*, 986 F.2d at 1458 (D.C. Cir.). Those two Circuits — like the Fifth — plainly adhere to a different understanding of their obligations under *Erie*.

The Eighth Circuit also has shown little reluctance about spinning new state law out of whole cloth. In *Hazen* v. *Pasley*, 768 F.2d 226 (1985), for example, that court concluded that the Missouri Supreme Court would recognize a right of action arising out of an alleged "wrongful domination" over property by Missouri law enforcement authorities. The Eighth Circuit justified its conclusion solely on the basis of certain regulatory policies of Missouri law enforcement agencies that appeared consistent with plaintiff's theory of recovery. *Id.* at 229. The Eighth Circuit essentially converted an internal regulatory policy into an implied right of action — precisely the type of "judicial activism" that circuits on the other side of the split categorically reject.

The Ninth Circuit has recognized the sharp inter-circuit conflict on this issue and apparently has sided with those circuits willing to make new state law:

> We note that the rule in other circuits is that the federal courts have limited discretion in a diversity case "to adopt untested legal theories brought under the rubric of state law."

Torres v. *Goodyear Tire & Rubber Co.*, 867 F.2d 1234, 1238 n.1 (1989) (quoting *Affiliated FM Ins. Co.* v. *Trane Co.*, 831 F.2d 153, 155 (7th Cir. 1987)). "For better or for worse," the court continued, "this circuit has not seen fit to assume such a posture of restraint when it comes to deciding novel questions of state law." *Ibid.* (citing *Paul* v.

Watchtower Bible & Trust Soc'y, 819 F.2d 875, 879 (9th Cir.), cert. denied, 484 U.S. 926 (1987)).

The Tenth Circuit appears to be internally divided on the issue. Some panels have attempted to divine how a State supreme court might rule on a novel theory on the basis of "doctrinal trends indicated by * * * policies." *Weiss* v. *United States*, 787 F.2d 518, 525 (1986). Others have indicated great reluctance to create new law where none existed before. See, *e.g.*, *Taylor* v. *Phelan*, 9 F.3d 882, 887 (1993) ("As a federal court, we are generally reticent to expand state law without clear guidance from its highest court; but where the expansion directly affects state finances and functions, we should take extra care."); see also *Mares* v. *Conagra Poultry Co.*, 773 F. Supp. 248, 252 (D. Col. 1991) ("a federal court sitting in diversity should not anticipate a change in existing state law"), aff'd, 971 F.2d 492 (10th Cir. 1992).

3. In this case, the Fifth Circuit cast its lot with the activist approach of the Second, Sixth, Eighth, and Ninth Circuits, directly contravening the rule in five other Courts of Appeals. The Fifth Circuit here adopted a theory of Texas law — consistently rejected by Texas courts — that a borrower has standing to bring an action under Article 21.21(16) of the Texas Insurance Code directly against its lender's insurer based on the insurer's handling of the lender's insurance contract. (The Fifth Circuit may have been driven to judicial activism in order to achieve the particular result it desired in this case; the court apparently was concerned about, inter alia, the "astonishing amount" of attorneys fees awarded to petitioner. App., *infra*, 3a.)[6]

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[6] In this connection, the court of appeals failed to appreciate that the majority of the attorneys fees resulted from collateral litigation brought on by Palma herself. As Palma conceded at trial, "the facts necessary to support [petitioner's] case [were] admitted from the very inception of the case." Trial Tr. 104; see *id.* at 82-94, 98-

The Fifth Circuit purported to find support for its new cause of action in dicta from a 1994 Texas Supreme Court decision, which *rejected* the argument that, under Article 21.21(16) of the Insurance Code, a third-party claimant could sue another party's insurer for the insurer's administration of the insurance contract. *Allstate Ins. Co.* v. *Watson*, 876 S.W.2d 145 (Tex. 1994). *Nowhere* in *Watson*, however, did the State Supreme Court discuss — much less disavow — the long line of intermediate appellate court authority holding that, in Texas, borrowers lack standing to bring such claims against the lenders' insurers. Moreover, as of the date the case was pending before the Fifth Circuit, there were (to our knowledge) *no* state court decisions in Texas that had held, as the Fifth Circuit did, that, under Article 21.21(16) of the Insurance Code, a borrower has standing to sue a lender's insurer based on the insurer's handling of the lender's insurance contract. (Nor are we aware of any since.) Indeed, all state court decisions have gone the other way. See pp. 3-4, *supra*.

In essence, the Fifth Circuit read *Watson* to signal a new direction in Texas jurisprudence that, *some day*, *might* result in the Texas Supreme Court overruling a well-established doctrine of state law. But rather than, in the interim, "apply[ing] the current law of [Texas], and leav[ing] it undisturbed," *Lead Indus. Ass'n*, 994 F.2d at 123 (3d Cir.), the Fifth Circuit decided that *it* was the appropriate court to extend *Watson* to what, in its view, was *Watson*'s logical conclusion. That is precisely the type of "reckless speculation," *Vargus*, 675 F.2d at 76 (3d Cir.), reliance on "'trend[s],'" *St. Regis Paper Co.*, 753 F.2d at 605 (7th Cir.), "expansion" of law, *Burris Chem., Inc.*, 10 F.3d at 247 (4th Cir.), and "ground [breaking]" jurisprudence, *American Inst. of Architects*, 986 F.2d at 1458 (D.C. Cir.), that is abjured in the more judicially conservative circuits.

102, 114-118.

4. Not only did the court of appeals boldly go where no Texas State court had gone before, it also *declined* to follow well-settled Texas decisions, apparently because they were rendered only by *intermediate* appellate courts. But absent state supreme court authority, the decisions of intermediate appellate courts *are* a state's law. As the Court recognized in *West* v. *AT&T*, 311 U.S. 223, 236-237 (1940):

> A state court is not without law save as its highest court has declared it. There are many rules of decision commonly accepted and acted upon by the bar and inferior courts which are nevertheless laws of the state although the highest court of the state has never passed upon them. In those circumstances a federal court is not free to reject the state rule merely because it has not received the sanction of the highest state court, even though it thinks the rule is unsound in principle or that another rule is preferable.

The Fifth Circuit was aware of the Texas precedent (see App., *infra*, 7a n.4), but refused to accept the intermediate appellate court decisions as the law of Texas. Purportedly it did so because the Texas Supreme Court's opinion in *Allstate Ins. Co.* v. *Watson*, 876 S.W.2d 145 (Tex. 1994), provided "persuasive data" that the law in Texas had abruptly changed. App., *infra*, 7a n.4. But *Watson* does not provide the credible evidence necessary for a federal court to overturn well-settled state law.

Watson held that an automobile accident victim, as a third-party claimant, lacks standing under Article 21.21(16) of the Insurance Code to sue the tortfeasor's insurer for the insurer's administration of the insurance contract. 876 S.W.2d at 150. The Texas court explained:

> The obligations imposed by art. 21.21 of the Insurance Code and *Vail* [v. *Texas Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129 (Tex. 1988)[7]] are engrafted onto the contract between the insurer and insured and are extra-contractual in nature. A third party claimant has no contract with the insurer or the insured, has not paid any premiums, has no legal relationship to the insurer or special relationship of trust with the insurer, and in short, has no basis upon which to expect or demand the benefit of the extra-contractual obligations imposed on insurers under art. 21.21 with regard to their insureds.

Id. at 149. *Nowhere* in the *Watson* opinion does the Texas Supreme Court mention — much less question — *Pineda* or its predecessors.

Nonetheless, the Fifth Circuit latched onto the *Watson* court's explanation of why third-party claimants lack standing under the Insurance Code, elevated that explanation to the level of "factors," and concluded that, in the case of a borrower, those factors militate *in favor of* standing to sue the lender's insurer under Article 21.21(16) of the Insurance Code. App., *infra*, 6a. The Fifth Circuit reached that conclusion even though, as the court itself acknowledged, the *Watson* court "did not expressly state that these factors were to be used when deciding whether a party was entitled to standing under [the Insurance Code]" (*ibid.*) and in doing so reversed long-settled Texas law (*id.* at 7a n.4). The Fifth Circuit's "data" are far too meager to base a conclusion that otherwise binding precedent is no longer good law.

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[7] *Vail* concerned the obligations owed by an insurer to its insured.

B. The Fifth Circuit's Approach In Establishing New State Law Is Inconsistent With The Principles Established In *Erie*

The sharp division among the circuits on the question presented by this petition arises because federal diversity courts often have difficulty delineating the limits of their authority under *Erie*. On the one hand, *Erie* and its progeny have established that federal diversity courts may not on their own authority alter existing state law:

> A federal court in a diversity case is not free to engraft onto those state rules exceptions or modifications which may commend themselves to the federal court, but which have not commended themselves to the State in which the federal court sits.

Day & Zimmerman, Inc. v. *Challoner*, 423 U.S. 3, 4 (1975) (per curiam); see *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64, 71 (1938) (rejecting rule that diversity courts are "free to exercise an independent judgment as to what the common law of the State is — or should be"); *United States* v. *Standard Oil Co.*, 332 U.S. 301, 313 (1947) ("in the federal scheme our part * * *, and the part of the other federal courts, outside the constitutional area is more modest than that of state courts, particularly in the freedom to create new common-law liabilities").

On the other hand, federal courts must apply state law in diversity cases even when that law is uncertain. Courts sitting in diversity have a duty to determine what a state supreme court would do in cases in which there is no state authority directly on point:

> *Erie R. Co.* v. *Tompkins* [] did not free the federal courts from the duty of deciding questions of state law in diversity cases. Instead it placed on them a greater responsibility for determining and applying state laws in all cases within their jurisdiction in which federal law does not govern. Accepting this responsibility, as was its

> duty, this Court has not hesitated to decide questions of state law when necessary for the disposition of a case brought to it for decision, although the highest court of the state had not answered them, the answers were difficult, and the character of the answers which the highest state courts might ultimately give remained uncertain.

Meredith v. *City of Winter Haven*, 320 U.S. 228, 237 (1943). Unfortunately, the only guidance that this Court gave to the lower federal courts in divining issues of state law is that the law is to be decided "with the aid of such light as was afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law." *Id.* at 238.

Tension between the obligation to apply state law in uncertain cases and the constitutional limitations on federal authority to make state law becomes acute when, as here, a federal court is asked not simply to make an "*Erie* guess," but to expand state law in a manner not contemplated, or indeed already rejected, by the state courts. As indicated above, some courts, like the Fifth Circuit, see their obligation as only to "stand in the shoes" of the state courts — authorized to forge new state law without restraint. Other courts apply state law, but heed the federalism and comity concerns that *Erie* and our constitutional system impose. Those courts recognize that their role is "more modest than that of state courts," *Standard Oil Co.*, 332 U.S. at 313, and refuse to expand state law. Only this latter rule resolves the tension in a manner consistent with the constitutional limitations that govern a federal court applying state law.[8]

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[8] The difference is not one of semantics. The innovative state lawmaking engaged in by the Fifth Circuit here, for example, would plainly be rejected in the First, Third, Fourth, Seventh, and District of Columbia Circuits. See pp. 10-12, *supra*.

The present case is a good illustration of the dangers of federal judicial activism in the application of state law. The Fifth Circuit essentially overruled an accepted and long-established rule of Texas law (see pp. 3-4, *supra)* based on nothing more than its judgment that dicta in a Texas Supreme Court opinion presaged a sea change in Texas law governing the relationship between borrowers and their lenders' insurers. To recognize what it perceived as the emerging state law, however, the Fifth Circuit had to abandon the current state law. And, when a federal court indulges in such a progressive and unguided exercise of lawmaking, it should not be surprising that it often will arrive at the wrong answer — as the Fifth Circuit did here. See Part II, *infra*.

There are significant costs to such federal court forays into state lawmaking. Here, for example, as a result of the Fifth Circuit's incorrect ruling, there now is one rule of Texas law for litigants in state courts and another rule for litigants who bring the same question of state law before federal courts sitting in diversity. As a result, whether future borrowers, such as Palma, will have standing to bring an action against lenders' insurers under Article 21.21(16) of the Texas Insurance Code will depend entirely on the courthouse in which the complaint is filed. Such discrepancies are intolerable under *Erie*. See *Fidelity Union Trust Co.* v. *Field*, 311 U.S. 169, 180 (1940) (it is impermissible "that there should be one rule of state law for litigants in the state courts and another rule for litigants who bring the same question before the federal courts owing to the circumstance of diversity of citizenship"); see also *Baldwin* v. *Alabama*, 472 U.S. 372, 374 (1985) (resolving "significant conflict" between the Eleventh Circuit and the Supreme Court of Alabama). Such a result is flatly inconsistent with the purpose of the Rules Enabling Act, which "is to avoid the maintenance within a state of two divergent or conflicting systems of law, one to be applied in state courts, the other to be availed of in federal courts, only in cases of diversity of

citizenship." *West*, 311 U.S. at 236. See generally *Guaranty Trust Co.* v. *York*, 326 U.S. 99, 109 (1945) ("In essence, the intent of [*Erie*] was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so as far as legal rules determine the outcome of a litigation, as it would be if tried in a State court.") The Court's review is necessary to correct the conflict between federal and state courts in Texas.[9]

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[9] It must be added that the question presented has substantial practical consequences for the mortgage insurance and housing industries in Texas. Until this decision, the relationship between borrower, lender, and the private mortgage insurer had been clear: The borrower is the lender's customer, the lender is the insurer's customer, private mortgage insurance protects the lender against the risk of default by the borrower, and the borrower is not a third-party beneficiary of the lender's insurance. See, *e.g.*, *Pineda*, 843 S.W.2d at 665; *Chaffin*, 731 S.W.2d at 730-731. As a result of the decision below, insurers now cannot be sure to whom they owe duties.

This is no trivial matter. The Fifth Circuit's opinion puts mortgage insurers in the hopeless position of owing duties to two parties who, if a claim is actually made, will likely be adverse to each other. Indeed, it was this fact, in part, that persuaded the *Watson* court that third-party claimants do *not* have standing to bring claims under the Insurance Code against another's insurer for the insurer's handling of an insurance contract. As that court explained:

> Were we to extend to third party claimants the same duties insurers owe to their insured, insurers would be faced with owing coextensive and conflicting duties. An insurer owes to its insured a duty to defend the insured *against* the claims asserted by a third party. * * *. [I]t is conceivable that in attempting to settle claims pursuant to the demands of a third party claimant, insurers may be liable to the insured for

II. AT A MINIMUM, THIS COURT SHOULD GRANT THE PETITION, VACATE THE JUDGMENT, AND EITHER CERTIFY THE STATE LAW QUESTION TO THE STATE SUPREME COURT OR REMAND TO THE FIFTH CIRCUIT FOR FURTHER CONSIDERATION IN LIGHT OF AN INTERVENING TEXAS INTERMEDIATE APPELLATE COURT DECISION

Although petitioner believes that the Fifth Circuit's decision is wrong as a matter of federal law under the principles enunciated in Part I, *supra*, at the very least the decision also is wrong as a matter of state law. In particular, just days after rehearing was denied in this case, another Texas intermediate appellate court specifically rejected the very rule adopted by the Fifth Circuit. *First Am. Title Ins. Co.* v. *Willard*, No. 12-93-00290-CV, 1996 WL 495583 (Aug. 29, 1996). App., *infra*, 89a-111a. In light of this intervening decision, *Vandenbark* v. *Owens-Illinois Co.*, 311 U.S. 538 (1941), and *Huddleston* v. *Dwyer*, 322 U.S. 232 (1944), instruct that the Court, pursuant to its authority under 28 U.S.C. § 2106, should grant, vacate, and either certify the state law question to the Texas Supreme Court or remand the case so that the Fifth Circuit may "conform [its] order[] to the State law." *Vandenbark*, 311 U.S. at 543. Because the *Willard* decision — which completely contradicts the Fifth Circuit's "*Erie* guess" — was rendered after the court of appeals issued its opinion in this case, a GVR order is entirely appropriate. See *Lawrence* v. *Chater*, 116 S. Ct. 604, 607 (1996) (per curiam).

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settling too quickly.

876 S.W.2d at 150 (emphasis in original). The precise conflicting duties warned of in *Watson* are the inevitable byproduct of the Fifth Circuit's decision here.

In *Willard*, a borrower obtained money from a savings and loan to build a home on a tract of land and entered into a lien contract with the construction contractor, which duly assigned the contract to the lender. To protect its loan collateral, the lender obtained title insurance, which, as a condition of the loan, it required the borrower to pay. *Id.* at 90a. During construction of the home, the parties discovered that the dwelling was being built over a pipeline, for which the pipeline owner had a valid easement. The title insurer acknowledged its responsibility for losses due to the easement, and offered to pay to relocate the pipeline. The pipeline company refused the offer, and no agreement was reached. After the house was completed, the borrower sued the title insurer, alleging, inter alia, that the insurer had engaged in unfair claim settlement practices in violation of Article 21.21(16) of the Texas Insurance Code. The trial court rendered judgment for the borrower, and the insurer appealed. See App., *infra*, 91a-92a.

On appeal, the insurer argued, inter alia, that pursuant to *Allstate Ins. Co.* v. *Watson*, 876 S.W.2d 145 (Tex. 1994), the borrower lacked standing to sue the insurer directly under Article 21.21(16) of the Insurance Code for a claim based on the mortgage contract. The borrower responded that *Watson* was distinguishable, inter alia, "because [the borrower] had paid the premium for the insurance policy."[10] App., *infra*, 98a. The court rejected the distinction, reasoning:

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[10] The borrower also argued that he had standing because "he would directly benefit from the payment by the insurer" to remove the pipeline. App, *infra*, 99a. The court rejected this argument, observing that "the insured * * * would benefit from [the insurer's] indemnification of the claim against it" and, "[a]s in *Watson*, a benefit to a third party does not thrust that party into a contractual relationship between the two other parties or confer upon [the borrower] a direct cause of action against [an insurer] for unfair claim settlement practices." *Ibid.*

> Customarily, the home builder/borrower pays this expense, because a lending institution must require that the borrower has title to the real property on which its loan proceeds will be expended. Rather than require the borrower to incur the expense of a title examination, a title insurance policy in favor of the lender is an inexpensive means of assuring the validity of its title * * *. We disagree that the borrower's act of paying the premium for the title insurance injects the borrower into the insurance contract as a party to the policy.

Id. The appellate court concluded that "[w]e do not agree that Willard's posture in this transaction circumvents the supreme court's opinion in *Watson*." *Id.* at 99a.

Willard and this case are factually indistinguishable, but legally irreconcilable. In *Willard*, the court, relying on *Watson*, expressly held that a borrower *did not have* standing to bring a direct cause of action against a lender's insurer under Article 21.21(16) of the Insurance Code based on an insurer's handling of a lender's insurance contract. Here, the Fifth Circuit — also purportedly interpreting *Watson* — concluded that a borrower *did have standing* to bring a direct cause of action against a lender's insurer under Article 21.21(16) of the Insurance Code for the insurer's handling of a lender's insurance contract.

When petitioner became aware of the *Willard* decision, it promptly filed with the Fifth Circuit a Motion for Recall of the Mandate, a Second Petition for Panel Rehearing, and a Second Suggestion for Rehearing *En Banc*, all of which currently are pending. A refusal by the Fifth Circuit to recall its mandate and conform its judgment with what plainly is the controlling law of Texas would conflict with this Court's guidance in *Huddleston*, 322 U.S. at 236-238, and *Vandenbark*, 311 U.S. at 543, and practice in *National Union Fire Ins. Co.* v. *American Medical International, Inc.*, 116 S. Ct. 510 (1995), and *Exxon Co., U.S.A.* v. *Banque de Paris et des Pay-Bas*, 488 U.S. 920 (1988). See also *Braniff*

Airways, Inc. v. *Curtiss-Wright Corp.*, 424 F.2d 427 (2d Cir.), cert. denied, 400 U.S. 829 (1970) (granting petition for rehearing, after petition for ceritorari was filed, in light of subsequent change in state law); *Scott* v. *Singletary*, 38 F.3d 1547, 1551 (11th Cir. 1994) (noting that court of appeals "ha[s] the power to recall its mandate if there has been a supervening change in the law"). As the Court observed in *Vandenbark*, 311 U.S. at 543 (footnoted omitted):

> [T]he dominant principle is that *nisi prius* and appellate tribunals alike should conform their orders to the state law as of the time of the entry. Intervening and conflicting decisions will thus cause the reversal of judgments which were correct when entered. * * * [U]ntil such time as a case is no longer *sub judice*, the duty rests upon federal courts to apply state law under the Rules of Decision statute in accordance with the then controlling decision of the highest state court. Any other conclusion would but perpetuate the confusion and injustices arising from inconsistent federal and state interpretations of state law.

The Court applied these principles — ironically in another Fifth Circuit case — in *Exxon Co., U.S.A.*, 488 U.S. at 920. There, the Fifth Circuit decided a issue involving a question of Texas law. Thereafter, a state intermediate appellate court, in a different case, decided the question contrary to the Fifth Circuit's understanding of Texas law. The losing party before the Fifth Circuit petitioned the Court for a writ of certiorari, which the Court granted. After briefing on the merits, the Court vacated the Fifth Circuit judgment and remanded for further consideration in light of the intervening state court decision.

If the Fifth Circuit refuses to adhere to the law of Texas in the present case, that decision will be more troubling than its earlier unwillingness to do so in *Exxon*. Here — unlike in *Exxon* — the subsequent intermediate appellate court decision was completely predictable; it was entirely consistent with a

long line of unquestioned intermediate appellate court decisions. See pp. 3-4, *supra*. The Fifth Circuit disregarded those decisions because it was convinced that the *Watson* case — *rejecting* third-party standing — presaged a reversal of well-established state law. But *Watson* is hardly the harbinger of a *change* in Texas law, as *Willard* now confirms. In short, if the Court does not grant review and consider the case on the merits, it should at a minimum vacate and either certify the state law question to the Texas Supreme Court or remand to the court of appeals for further consideration in light of *Willard*.[11]

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[11] The alternative of certifying the question to the Texas Supreme Court makes particularly good sense in light of the majority's refusal in the decision below to apply well-settled decisions of the intermediate state courts of Texas.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted. In the alternative, the petition should be granted, the judgment vacated, and either the state law question certified to the Texas Supreme Court or the case remanded to the court of appeals for further consideration in light of the decision in *First American Title Insurance Co.* v. *Willard*.

Respectfully submitted.

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OCTOBER 1996

APPENDIX A

UNITED STATES COURT OF APPEALS, FIFTH CIRCUIT

No. 95-20034.

[Filed: April 16, 1996]

NANCY ABSHIRE PALMA, PLAINTIFF-APPELLANT,

v.

VEREX ASSURANCE, INC., DEFENDANT-APPELLEE.

Appeal from the United States District Court for the Southern District of Texas.

Before DAVIS and PARKER, Circuit Judges, and BUNTON[1], District Judge.

ROBERT M. PARKER, Circuit Judge:

I. FACTS

On November 28, 1983, plaintiff-appellant Nancy Palma ("Palma") borrowed $121,300 from City Federal Savings & Loan ("City Federal") to purchase a condominium. As a condition of the loan, Palma was required to purchase mortgage insurance to protect City Federal from a loss in the event she defaulted on the loan. The mortgage insurance was purchased by City Federal from defendant-appellee Verex Assurance, Inc. ("Verex"). The premiums were paid with Palma's money, which had been placed in an escrow account.

Palma lived in the condominium until November of 1986, when she moved out of the property and used it as rental property. In 1988, Palma defaulted on her obligation to

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[1] District Judge of the Western District of Texas, sitting by designation.

repay the note. After the default City Federal foreclosed on the condominium. On May 3, 1988, the property was sold at public auction for $30,800 to City Federal, the mortgage holder. After the foreclosure there remained a principal balance of $115,825.14 due and owing to City Federal under the terms of the note. On June 23, 1989, Verex paid City Federal $51,122.47 pursuant to the mortgage insurance policy and received an assignment of the entire deficiency due on Palma's note.

On April 1, 1991, Verex, as subsequent assignee of City Federal, demanded that Palma repay $117,521.98 as the "deficiency balance due." This amount included accrued interest and costs of foreclosure, as well as a credit for the proceeds received from the foreclosure of the condominium. The amount demanded did not include a credit for the proceeds Verex paid to City Federal under the mortgage guarantee insurance policy.

We have had difficulty in sorting out the record concerning the economic facts of the claims in this litigation and have been unable to resolve some apparent inconsistencies. However, we believe we can at least get in the ballpark with a summary that approaches accuracy.

Palma paid $121,300 for the house. She made mortgage payments and payments for the mortgage insurance for approximately four years. However, after four years of mortgage payments and a $30,800 credit to her balance from the foreclosure proceeds, she still owed $115,825.14. The difference apparently was attributable to charges assessed against Palma by City Federal's attorneys. To state it another way, Palma was assessed foreclosure costs that in effect wiped out the $30,800 credit from the foreclosure proceeds. However, the story is far from over. By the time the court granted Verex's motion for summary judgment and ruled against Palma on her wrongful foreclosure claim she was assessed additional attorneys' fees for Verex's lawyers in the

astonishing amount of $225,750. This additional amount raised the judgment against Palma to a total of $419,898.12.

II. PROCEEDINGS BELOW

Palma filed suit in state district court alleging that Verex's pursuit of the deficiency was in violation of the terms of the mortgage insurance policy. Based upon diversity jurisdiction Verex removed the suit to the Southern District of Texas and filed a counterclaim for the deficiency and attorneys' fees.

Palma then sought to have her claims against Verex certified as a class action. The case was referred to a magistrate judge for pretrial management. The magistrate initially recommended that some of Palma's claims be certified in a class action but set aside that recommendation after reconsidering Palma's standing. The magistrate found Palma was not a third-party beneficiary of the insurance contract and recommended that class certification be denied as to any and all claims based upon an assertion of third-party beneficiary status. The magistrate then recommended that Verex's motion for summary judgment be granted and recommended the dismissal of all of Palma's claims except those alleging debt collection violations, violations of the Deceptive Trade Practices Act ("DTPA"), and wrongful foreclosure. The district court adopted the magistrate's recommendations thereby denying class certification of the dismissed claims and granting Verex's motion for summary judgment of all claims, except wrongful foreclosure.

The case proceeded to trial on Palma's wrongful foreclosure claim. After a one day bench trial the district court issued its findings of facts and conclusions of law and entered final judgment in favor of Verex. The judgment awarded Verex $419,898.12. Palma appealed.

III. ANALYSIS

A. STANDING & ART. 21.21

The district court granted Verex's motion for summary judgment as to Palma's claims based upon alleged violations of the Texas Insurance Code after concluding that Palma did not have standing to assert those claims under art. 21.21(16) of the Texas Insurance Code.[2] We review the district court's grant of summary judgment de novo. *Thomas* v. *Price*, 975 F.2d 231, 235 (5th Cir. 1992).

The district court's jurisdiction in this case was based on diversity of citizenship and it correctly held that it was bound to apply the substantive law of the State of Texas. *Erie R. Co.* v. *Tompkins*, 304 U.S. 64, 78, 58 S.Ct. 817, 822, 82 L.Ed. 1188 (1938). We begin our review of the district court's decision by examining the applicable law.

Art. 21.21(16) of the Texas Insurance Code provides:

> *Any person* who has sustained actual damages as a result of another's engaging in an act or practice declared in § 4 of this Article ... [to be] unfair or deceptive acts ... in the business of insurance or in any practice defined by § 17.46 of the Business and Commerce Code ... as an unlawful trade practice may maintain an action against the person ... engaging in such acts. (emphasis added).

Although "any person" would appear to be sufficiently broad to permit Palma to have standing, it appears to have been narrowly construed. This court, interpreting the laws of Texas, has held that "absent privity of contract or some sort of reliance by the person bringing the claim on the words or deeds of the insurer, a suit will not lie under art. 21.21."

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[2] The actual analysis of all issues disposed of by summary judgment was conducted by the magistrate. However, we will refer to the analysis as though it were conducted by the trial court because it adopted the magistrate's recommendations.

Warfield v. *Fidelity and Deposit Co.*, 904 F.2d 322, 327 (5th Cir. 1990). In reaching this holding the court analyzed two decisions from the Texas courts of appeal that had addressed standing under art. 21.21. The first case was *Chaffin* v. *Transamerica Ins. Co.*, 731 S.W.2d 728, 731 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.). The court, discussing *Chaffin*, stated that the Texas court "held that the term 'person' in art. 21.21 means either an insured or a beneficiary of the policy." *Warfield*, 904 F.2d at 326. The second case was *Hermann Hosp.* v. *National Standard Ins. Co.*, 776 S.W.2d 249, 252 (Tex. App.—Houston [1st Dist.] 1989, writ denied). The court noted that *Hermann* broadened standing under art. 21.21 to include persons who had relied on representations of the insured. *Warfield*, 904 F.2d at 327. Despite expressly recognizing that *Chaffin* extended standing to beneficiaries of insurance policies, *Warfield* limited standing to those with privity of contract or those who had relied on the words or deeds of the insurer. This analysis was later recognized as "the new test" for determining standing under art. 21.21. *In Re Burzynski*, 989 F.2d 733, 741 (5th Cir.1993).

The Texas Supreme Court recently addressed standing under art. 21.21 in the context of a claim asserted under an automobile liability policy by a third-party claimant in a direct action against an insurer arising out of an accident with the insured. In that type of action, the court held that third-party claimants are not entitled to standing under art. 21.21. *Allstate Ins. Co.* v. *Watson*, 876 S.W.2d 145, 150 (Tex. 1994). The court found that the following factors weighed against granting standing to the third-party claimant: A third-party claimant has no contract with the insurer or the insured, has not paid any premiums, has no legal relationship to the insurer or special relationship of trust with the insurer, and in short, has no basis upon which to expect or demand the benefit of the extra-contractual obligations imposed on insurers under art. 21.21 with regard to their insureds. *Id.* at

149. The court then noted that although it had previously extended standing to third-party beneficiaries of automobile insurance policies, it refused to extend standing to third-party claimants of those policies under art. 21.21. *Id.* at 150 (citing *Dairyland County Mut. Ins. Co.* v. *Childress*, 650 S.W.2d 770 (Tex.1983)).[3]

Due to the unique nature of the mortgage insurance policy in the instant case, Palma, unlike the third-party claimant in *Watson*, satisfies most of the factors discussed by the Texas Supreme Court that weighed against standing in that case. Palma had a contract with the insured, City Federal, in the form of a mortgage. Palma paid the premiums for the mortgage insurance. Additionally, Palma is designated by name in the certificate of insurance issued by Verex to City Federal. The considerations that weighed against standing in *Watson* weigh in favor of granting Palma standing in the instant case. However, because the court did not expressly state that these factors were to be used when deciding whether a party was entitled to standing under art. 21.21 we must determine what the Texas Supreme Court would do if it were presented with the issue before us.

"When presented with an unsettled point of state law, our role under *Erie* is to determine how the [Texas] Supreme Court would resolve the issue if presented with it." *Coatings Mfrs., Inc.* v. *DPI, Inc.*, 926 F.2d 474, 479 (5th Cir.1991). The factors discussed by the Texas Supreme Court in *Watson* that weighed against extending standing to the third-party claimant in that case are present in the instant case. This, combined with the unique nature of mortgage insurance, we

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[3] In *Dairyland* the court held that for purposes of recovering attorney's fees under an automobile insurance policy, a third party who has obtained a judgment against an insured is an intended third-party beneficiary of the automobile insurance policy and is entitled to standing in order to enforce the policy provisions. *Dairyland County Mut. Ins. Co.*, 650 S.W.2d at 775-76.

believe impacts on our analysis of standing under art. 21.21. Consequently, we conclude that if the Texas Supreme Court were presented with the question before us it would hold that standing under art. 21.21 is satisfied by not only those who can establish privity of contract or reliance on a representation of the insurer, but also by those who can establish that they were an intended third-party beneficiary of the insurance contract.[4] Therefore, we must determine whether Palma was an intended third-party beneficiary of the contract between Verex and City Federal in order to determine if the district court was correct when it found that Palma lacked standing to sue under art. 21.21.

1. Third-party Beneficiary Status

Under Texas law, in order for Palma to qualify as a third-party beneficiary of the insurance contract she must prove three things: (1) that she was not privy to the written agreements between Verex and City Federal; (2) that the contract was made at least in part for her benefit; and (3)

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[4] But see, *Pineda* v. *P.M.I. Mtg. Ins. Co.*, 843 S.W.2d 660, 665 (Tex. App.—Corpus Christi 1992) *writ denied per curiam*, 851 S.W.2d 191 (Tex. 1993). In Pineda, the Corpus Christi court stated, "[T]he [borrowers] were neither insureds under the [mortgage insurance] policy, nor in contractual privity with the [insurer]. Nor were they beneficiaries under the policy of insurance to ... the lender." *Id.* Although the Texas Supreme Court denied writ, it stated that it was neither approving or disapproving of the appellate court's decision. *Pineda* v. *P.M.I. Mtg. Ins. Co.*, 851 S.W.2d 191 (Tex. 1993). While we are not bound by the holdings of state appellate courts, we are not to disregard them unless we are convinced by other persuasive data that the Texas Supreme Court would rule otherwise. *West* v. *American Tel. & Tel. Co.*, 311 U.S. 223, 237, 61 S.Ct. 179, 183, 85 L.Ed. 139 (1940). *Watson's* discussion of factors that weighed against standing under art. 21.21 in that case presents us with such data.

that the contracting parties intended for Palma to benefit by their written agreements. *Talman Home Fed. Sav. & Loan Ass'n of Illinois* v. *American Bankers Ins.*, 924 F.2d 1347, 1350 (5th Cir. 1991) (internal citations omitted).

It is undisputed that Palma was not privy to the contract entered into between Verex and City Federal, thereby satisfying the first element of the analysis. Whether the contract was made for her benefit is derived solely from the language of the contract. *Id.*

Condition 15 of the contract for mortgage insurance states:

> 15. NO RIGHT OF SUBROGATION AGAINST THE BORROWER. The Borrower shall not be liable to the Company for any loss paid to the Insured pursuant to this policy; provided, however, that the real estate shall consist of a single-family dwelling occupied by the Borrower; otherwise, the Company reserves the right to make a claim against the Borrower for any loss paid or deficiency suffered by the Company. This language benefits the borrower only, in this case Palma. However, the very next condition in the contract states:
>
> 16. TO WHOM PROVISIONS APPLICABLE. The provisions of this policy shall inure to the benefit of and be binding upon the Company and the Insured and their successors and assigns.

Under Texas law, contracts for insurance are generally enforced as written; however, ambiguous insurance contracts are interpreted against the insurer. *National Union Fire Ins. Co.* v. *Hudson Energy Co., Inc.*, 811 S.W.2d 552, 555 (Tex. 1991). The interpretation of an insurance contract, including whether it is ambiguous, is a legal determination subject to de novo review. *Truehart* v. *Blandon*, 884 F.2d 223, 226 (5th Cir. 1989). Therefore, we must examine Condition 15 and Condition 16 in order to determine if an ambiguity exists.

Condition 15 is written for the sole benefit of the borrower. The policy specifies additional beneficiaries in Condition 16 which states that the policy provisions are written for the benefit of Verex and City Federal. Neither condition is mutually exclusive. However, if these two provisions create an ambiguity it is to be construed against Verex. *National Union Fire Ins. Co.*, 811 S.W.2d at 555. In any event, we find no ambiguity created by Conditions 15 and 16. We also find that the insurance contract was actually made, in part, for the benefit of Palma.

Finally, we must determine if Verex and City Federal intended the contract to benefit Palma. The intent of the contracting parties is discerned from the four corners of the instrument. See *Talman*, 924 F.2d at 1350 ("It is the intention and purpose of the contracting parties, as disclosed within the four corners of the instrument, which should control") (internal citation omitted).

One Texas court has stated that "[w]here a stranger contends that it was intended that the provisions of a contract should inure to his benefit such intention must be clearly apparent. If there is any doubt concerning the intent in this regard as it appears from the contract itself, such doubt should be construed against such intent." *Republic Nat'l Bank* v. *Nat'l Bankers Life Ins. Co.*, 427 S.W.2d 76, 80 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.); see *Talman*, 924 F.2d at 1351 (quoting *Republic Nat'l Bank*). Palma is not a stranger to the insurance contract between Verex and City Federal; she is specifically identified as the borrower in the contract itself. Consequently, the *Talman* decision does not affect our analysis.

The contract for insurance was clearly intended, in part, to benefit Palma.[5] Consequently, the three elements having

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[5] See "CONTRACTUAL RIGHTS AND ASSIGNMENT", infra, for a discussion of the benefits conferred on Palma.

been satisfied, we find that Palma is an intended third-party beneficiary of the contract for mortgage insurance entered into between Verex and City Federal.

Having determined that Palma is an intended third-party beneficiary, it would appear that a reversal of the trial court's grant of summary judgment on this issue is all that remains for us to do. However, in finding of fact seven the trial court alternatively found that even if Palma were a third-party beneficiary she could not enforce the contract for insurance. This alternative finding was based upon the district court's interpretation of language contained within Condition 15 of the contract for insurance relating to whether the contract's validity was dependent upon Palma occupying the property.

2. Owner Occupancy

We review conclusions of law de novo and findings of fact for clear error. *Switzer* v. *Wal-Mart Stores, Inc.*, 52 F.3d 1294, 1298 (5th Cir. 1995). The district court classified its alternative determination of the applicability of Condition 15, which focused upon occupancy, as a finding of fact. However, because this finding was based upon an interpretation of the policy it is reviewed as a conclusion of law. *Harbor Ins. Co.* v. *Urban Constr. Co.*, 990 F.2d 195, 199 (5th Cir. 1993). Consequently, we conduct a de novo review.

Condition 15 states that the borrower is not liable to Verex "for any loss paid to the Insured pursuant to this policy; provided, however, that the real estate shall consist of a single-family dwelling occupied by the Borrower." (emphasis added). Consequently, we must determine whether Palma was required to occupy the property at the time of default in order to be entitled to the protection afforded to borrowers by Condition 15.

Condition 15 provides us with no guidance as to when occupancy is to be determined. If occupancy is determined at the time the contract was entered into, then Palma is

clearly within the language of Condition 15. However, if occupancy is determined at the time of default, then the district court correctly found that Palma was afforded no protection. The ambiguity is apparent and it must be interpreted against Verex. *National Union Fire Ins. Co.*, 811 S.W.2d at 555. Therefore, we hold that occupancy is determined at the time the contract of insurance was entered into and the policy was issued. As a result of this determination, we find that the district court erred in its alternative finding, and we hold that Palma satisfied the language of the policy by occupying the dwelling at the time the contract of insurance was entered into and the policy was issued. The impact of the court's error, concerning Palma's ability to enforce the terms of the contract, is discussed below.

B. Assignment Of The Deficiency Balance

Palma contends that the assignment of the deficiency balance to Verex violated her contractual rights, specific statutes, and/or the public policy of the State of Texas. We will address each of these arguments.

1. Contractual Rights And Assignment

Palma, by virtue of her status as a third-party beneficiary, is a borrower who has contractual rights. See *Temple Eastex, Inc.* v. *Old Orchard Creek Partners, Ltd.*, 848 S.W.2d 724, 730 (Tex. App.—Dallas 1992, writ denied). She is entitled to enforce the conditions contained in the insurance policy that affect her. See *Id.* (the "third-party beneficiary" ... is entitled to rely upon and to enforce all of the contract's provisions.). Although the trial court erroneously found that Palma was not entitled to enforce the conditions contained in the contract for insurance, it proceeded to interpret the conditions contained in the contract for insurance in order to determine the amount of the deficiency that Verex was entitled to collect.

In finding of fact number five, the trial court found that Palma was entitled to a credit of $30,800—the amount of proceeds received at foreclosure. In finding of fact number six, the trial court found that "the deficiency debt due and owing, after applying all lawful and proper credits, is $115,825.14." This is the amount that the trial court determined that City Federal was entitled to collect from Palma—the same amount that was ultimately assigned to Verex. The trial court classified these findings as "findings of fact", but they were based upon the trial court's interpretation of conditions contained in the contract for insurance. Consequently, we conduct a de novo review in order to determine if the trial court erred when it determined the amount of the deficiency due and owing by Palma. See *Harbor Ins. Co.*, 990 F.2d at 199.

a. Condition 10 and Bidding Requirements

When City Federal elected to collect mortgage insurance proceeds, the contract for insurance imposed bidding requirements upon City Federal. These bidding requirements therefore impacted the amount that might remain as a deficiency after foreclosure on Palma's property. The relevant conditions of the policy form read as follows:

> 10. PROCEDURE UNDER FAULT ... The Insured shall also furnish to the Company, at least (15) days prior to the foreclosure sale, if any, a statement indicating the amount anticipated to be due, at the time of sale, to the Insured under the terms of the policy and shall be required to bid, at the sale, the amount due to the Insured under the terms of the policy (emphasis added)....
>
> 11. COMPUTATION OF LOSS—The amount of loss payable to the Insured shall be limited to the principal balance due pursuant to the mortgage agreement, accumulated interest computed through the date of the tender of conveyance, as hereinafter set forth (penalty

interest excluded), real estate taxes and hazard insurance premiums necessarily advanced.

13. OPTION TO PAY A PERCENTAGE OF THE AMOUNT DUE—In lieu of conveyance of the title to the mortgage premises and payment in accordance with Condition 11, the Company shall have the option of paying the percentage of the amount due to the Insured in accordance with the amount of coverage selected and paid for as indicated on the face of the Certificate, or subsequent Certificate amendments, and shall have no claim to said real estate, such payment to be full and final discharge of the Company's liability.

Palma contends that under the provisions quoted above, if City Federal intended to collect the mortgage insurance proceeds it was required to bid the total amount of the debt due at foreclosure, thereby eliminating the deficiency balance on the note.

The trial court considered Palma's "full-debt bid argument" but rejected it. In finding of fact number one the court found that Condition 10 did not require the lender to pay as its bid at foreclosure sale the full amount of the loan. However, the trial court did not specify what Condition 10 did require of City Federal.

b. "Full-Debt Bid Argument"

If City Federal intended to collect the proceeds of the mortgage insurance policy after foreclosure, Condition 10 required it to bid "the amount due to [City Federal] under the terms of the policy." Palma contends that the amount due under the terms of the policy is to be determined by looking at the language contained in Condition 11, entitled "Computation of Loss". If we were to adopt the reasoning preferred by Palma, we would be requiring lenders who

entered into contracts prior to February 24, 1984,[6] to bid the entire amount due under the terms of the mortgage if they intended to collect mortgage proceeds after foreclosure.

The approach urged by Palma is contrary to the law as it existed at the time in question. If a debtor wanted to challenge the amount bid by the lender at foreclosure the law in Texas required the debtor to establish: (1) that the amount of proceeds received from sale at foreclosure was "grossly inadequate", and (2) an irregularity in the foreclosure sale. Only after a finding of both "gross inadequacy" and irregularity would the court prohibit the proceeds from being used in calculating the deficiency. *Thompson* v. *Chrysler First Business Credit Corp.*, 840 S.W.2d 25, 33 (Tex. App.—Dallas 1992, no writ). Though this approach was amended by statute in early 1991,[7] the amendment does not affect our decision concerning what amount the lender was legally obligated to bid prior to the statutory change.

Condition 10 requires the lender to bid either: (1) the full amount of the balance due on the note, as defined in Condition 11, or (2) no less than twenty-five percent of the balance. Either of these approaches was permitted under the terms of the contract for insurance, as long as the amount bid

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[6] On this date the Texas Board of Insurance issued Board Order 44262, in which the language governing bidding requirements was deleted.

[7] This judge-made rule was changed by statute in April of 1991, when the Texas legislature enacted § 51.003 of the Texas Property Code, which among other changes, permitted the borrower to request that the court in which the action is pending to determine the fair market value of the real [foreclosed] property as of the date of the foreclosure sale. If the court determines that the fair market value exceeded the foreclosure price at the time of foreclosure, the person against whom the deficiency is sought is entitled to an offset equal to the excess amount.

was not "grossly inadequate" and there had been no irregularity in the foreclosure sale.

By requiring the lender to bid a minimum of twenty-five percent of the total amount due before being entitled to collect insurance proceeds, the borrower was afforded some degree of assurance that he would be receiving a fair credit on his deficiency balance. The lender still had to bid an amount that complied with Texas law, and this amount might be more than the minimum twenty-five percent, but in no event should it have been less. The lender could also bid an amount that was both less than twenty-five percent and not violative of Texas law, as long as he did not intend to collect mortgage guaranty insurance proceeds. Only when the lender intended to collect insurance proceeds would he be obligated under the terms of the contract to bid a minimum of twenty-five percent, assuming that this amount was neither "grossly inadequate" nor the result of an irregularity in the foreclosure sale.

In the instant case, City Federal purchased the property at foreclosure for $30,800.[8] This amount was then credited

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[8] Palma entered into an earnest money contract with a third party on April 7, 1988, wherein the parties agreed to a purchase price of $60,000. City Federal refused to approve the sale. Then, on November 28, 1983, the property was purchased at foreclosure by City Federal for $30,800. City Federal then collected insurance proceeds of $51,122.47 and subsequently sold the property for approximately $57,000 just two months later. Verex then was assigned the right to pursue Palma on the deficiency remaining on the note. At trial, the general counsel for Verex, Thomas Anderson, stated that Verex occasionally advised lenders as to what amount to bid at foreclosure, but could not remember for certain if they had advised City Federal in the instant case. This is a peculiar practice, in light of the fact that Verex and City Federal disregarded the terms of the insurance contract that dictated bidding at foreclosure. It is apparent that a mortgage insurer, who intends

against Palma's deficiency balance. The trial court found that the amount bid by City Federal was not "grossly inadequate". It is not necessary for us to determine whether the trial court erred when it found that the amount bid by City Federal was not "grossly inadequate" because it is clear that the trial court erred when it found that there had been no violation of Condition 10 of the contract.

If the trial court had interpreted Condition 10 as written, it would have found that City Federal was required to submit a minimum bid of twenty-five percent, or $37,139.72.[9] The trial court's error in interpreting Condition 10 was compounded when it failed to properly credit the deficiency balance that would have remained after foreclosure. Palma was entitled to a credit of $37,139.72 in proceeds from the sale at foreclosure, leaving a deficiency balance of $111,447.16.[10] As discussed below the trial court further erred when it failed to credit this deficiency with the insurance proceeds received by City Federal.

c. Condition 15 and Waiver of Subrogation

Condition 15 waived Verex's rights to pursue Palma "for any loss paid to the insured pursuant to this policy." The

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to receive an assignment to pursue borrowers for deficiencies, has an interest in the property being sold at foreclosure for the lowest price possible. After all, the insurer is obligated by contract to pay proceeds to the insured. If he can minimize the amount received at foreclosure, then the amount of the remaining deficiency will be larger. This is one of the dangers that the policy language protected against, and it provides support to our interpretation of the contractual conditions at issue in the instant case.

[9] Total indebtedness at time of foreclosure x .25, or: $148,558.88 x . 25 = $37,139.72.

[10] Total indebtedness at time of foreclosure - sale proceeds, or: $148,588.88 - $37,139.72 = $111,447.16.

amount paid to City Federal was $51,122.47. It is clear that Palma was entitled to enforce the waiver of subrogation rights present in Condition 15, which entitled her to a credit of $51,122.47 on the amount assigned by City Federal to Verex.[11] The trial court should have properly credited the deficiency balance owed by Palma with the amount paid by Verex to City Federal. If it had done so it would have found that the deficiency assignable to Verex was $60,326.69.[12]

The errors committed by the trial court in determining the amount of the deficiency balance caused it to further err in finding of fact number eight. In finding of fact number eight the trial court stated that "Verex is the assignee of the deficiency claimed, and has the right to recover it under the lawful assignment agreement." This finding is erroneous because the assignment agreement violated the express terms of the contract, thereby violating Palma's rights as a third-party beneficiary. As a result of the errors present in

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[11] But cf. *Hunt* v. *Jefferson Sav. & Loan Ass'n*, 756 S.W.2d 762, 765 (Tex. App.—Dallas 1988, writ denied), *cert. denied*, 489 U.S. 1079, 109 S.Ct. 1532, 103 L.Ed.2d 837 (1989). In *Hunt*, the court found that the borrower was not entitled to an offset for mortgage insurance proceeds received by the lender. The instant case is distinguishable because we are not offsetting the amount recoverable by the lender. Instead, we are crediting the insurance proceeds against the amount assigned by the lender to the insurer because the insurance contract prohibits the insurer from recovering those proceeds. Additionally, since the time that *Hunt* was written the Texas legislature has enacted § 51.003(d), which requires the lender to credit a borrower's deficiency balance with any mortgage insurance proceeds that are received. This enactment essentially reverses *Hunt*.

[12] $148,588.88 (total indebtedness at time of foreclosure) - $37,139.72 (minimum bid required by Condition 10) - $51,122.47 (Condition 15 limit on subrogation rights) = $60,326.69 (amount assignable to City Federal)

the trial court's finding of facts, we must reverse the judgment of the trial court.

2. Illegal Assignment

Palma contends that the assignment agreement entered into between City Federal and Verex was illegal because it violated art. 21.21A of the Texas Insurance Code, which provides, in part:

> Section 1. No insurer ... may make any contract of insurance or agreement as to such contract other than as expressed in the policy issued thereon....
>
> Section 3. If any person violates any of the provisions of this Article, the person shall, in addition to any other penalty specifically provided, be guilty of a Class A misdemeanor.
>
> Section 4. The commissioner, upon giving 10 days' notice of hearing by certified mail, and upon hearing, may suspend or cancel the certificate, charter, permit, or license to engage in the business of insurance of any society, association, corporation, or person violating the provisions of this Article.

The agreement entered into between Verex and City Federal clearly violated the original contract for insurance. The assignment agreement gave Verex the right to pursue Palma for the entire amount of the deficiency balance. This amount included the amount which Verex had paid to City Federal in insurance proceeds, which, as previously stated, violated Condition 15's limitation on Verex's subrogation rights. Under art. 21.21A the agreement was "other than as expressed in the policy" and was therefore illegal. "It is a familiar law of contracts that an illegal agreement is unenforceable." *DiFrancesco* v. *Houston Gen. Ins. Co.*, 858 S.W.2d 595, 598 (Tex. App—Texarkana 1993, no writ). The illegality of the agreement giving Verex the right to pursue

Palma for the deficiency provides an independent ground for reversing the judgment of the trial court.

3. Public Policy

Our decision to reverse the judgment of the trial court is strengthened by public policy considerations. The public policy of the State of Texas may be derived from its constitution, statutes, and judicial decisions. *Dairyland County Mut. Ins. Co.* v. *Wallgren*, 477 S.W.2d 341, 342 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.). Terms and conditions in the contract for insurance, which have been prescribed and approved by the Insurance Board, represent the public policy of the state. *Id.* However, actions by the Board which are contrary to relevant statutes or decisions of the courts do not represent public policy. See *American Liberty Ins. Co.* v. *Ranzau*, 481 S.W.2d 793, 796-97 (Tex. 1972) ("the Board may not act contrary to but only consistent with, and in furtherance of, the express statutory purposes."); *Nat'l County Mut. Fire Ins. Co.* v. *Johnson*, 829 S.W.2d 322, 326 (Tex. App.—Austin 1992, aff'd, 879 S.W.2d 1) (Insurance Board's actions which are contrary to express legislative policy do not represent public policy).

In the instant case there are no statutes or judicial decisions for the time period in question that provide us with guidance for determining the public policy as it relates to the propriety of the assignment agreement entered into between Verex and City Federal.[13] However, because the language

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[13] It is clear that the current public policy of Texas clearly prohibits the assignment agreement at issue. The current statute, which partially governs mortgage guaranty insurance, in part provides: No policy of mortgage guaranty insurance shall contain a provision which allows subrogation rights or any other claim by the insurer against the borrower for a deficiency arising from a foreclosure sale of a single-family dwelling occupied by the borrower as the principal residence of the borrower. Tex. Ins. Code Ann. Art. 21.50 § 1A(c) (Vernon 1996) (emphasis added).

contained in the contract for insurance was expressly approved and adopted by the Texas Board of Insurance, we have a basis for discerning Texas' public policy as it relates to the actions of Verex. See *Wallgren*, *supra*.

On May 11, 1970, the Texas Board of Insurance issued Board Order 13772. As required by statute, Verex incorporated every condition contained in the order into its policy for mortgage insurance. Included in the order were Conditions 10 and 15, which as previously discussed, were both violated by City Federal and Verex. Condition 10 was violated when City Federal failed to place a proper bid at foreclosure, which resulted in a larger deficiency than would have existed if City Federal had placed a proper bid. Verex then pursued Palma for this incorrect deficiency without crediting it with the amount of insurance proceeds paid to City Federal. Their failure to credit the deficiency balance resulted in a violation of Condition 15. The violations of Conditions 10 and 15 were violations of the public policy of the State of Texas and they provide an independent basis for reversing the judgment of the trial court.

C. Class Certification

Palma contends that the district court improperly considered the merits of the case when determining whether the case should be certified as a class action. There were approximately sixteen separate issues disposed of by the trial court's judgment, including the trial court's decision not to certify Palma's claims in a class action. However, the only

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Assignment of the right to pursue Palma for a deficiency falls squarely within the prohibition restricting insurers from pursuing borrowers for deficiencies via "subrogation rights or any other claim". However, because the contract for insurance between Verex and City Federal was entered into in late 1983 we must determine what the public policy of Texas, as it relates to mortgage guaranty insurance, was at that time.

issues addressed by Palma on appeal are: (1) the trial court's grant of summary judgment based upon its finding of lack of standing to sue under art. 21.21, (2) the trial court's judgment denying Palma relief for wrongful foreclosure, and (3) the trial court's judgment on Verex's deficiency claim and the related claim for attorneys' fees. Because she did not raise the other claims on appeal, the trial court's disposition of those other claims is final. See *Matter of Texas Mortgage Servs. Corp.*, 761 F.2d 1068, 1073 (5th Cir. 1985) ("issues not raised on appeal in the brief of the Appellant may be considered waived, and they cannot be noticed or entertained by the Court of Appeals"). The finality of those other rulings precludes her from qualifying as a class representative in the event a class is subsequently certified wherein the class representative asserts claims that are the same or substantially similar to those asserted by Palma which were not appealed. See Fed. R. Civ. P. 23(a) (class representative must "fairly and adequately protect the interests of the class"). Therefore, we need not determine whether the trial court erred when it denied class certification.

IV. CONCLUSION

Palma requests this court to reverse the judgment of the trial court. However, the only issues that have been adequately briefed are those that relate to wrongful foreclosure, Verex's counterclaim for the deficiency and attorneys' fees, and the grant of summary judgment to Verex on the issue of standing under art. 21.21. Accordingly, our reversal of the trial court's judgment is limited to those issues. All issues not raised are waived and the judgment is final as to those other issues. Therefore, the judgment of the trial court is REVERSED in part, AFFIRMED in part, and the case is REMANDED for further proceedings consistent with this opinion.

W. EUGENE DAVIS, Circuit Judge, dissenting:

I disagree with the majority's legal conclusion that Palma is a third-party beneficiary of Verex's policy. I therefore dissent.

The majority holds that Clause 15 of the policy makes Palma a third-party beneficiary to the insurance contract. Clause 15 provides:

> NO RIGHT OF SUBROGATION AGAINST THE BORROWER.
>
> The Borrower shall not be liable to the Company for any loss paid to the Insured pursuant to this policy; provided, however, that the real estate shall consist of a single-family dwelling occupied by the Borrower; otherwise, the Company reserves the right to make a claim against the Borrower for any loss paid or deficiency suffered by the Company.

I agree with the majority that, when its conditions are met, Clause 15 is designed to afford a waiver of subrogation from the insurer to the borrower. It is clear to me, however, that in this case all of the conditions were not met; the real estate which served as collateral for the subject loan was not a "single family dwelling occupied by the borrower" at the time of the loss.

The majority disposes of the occupation condition by concluding that the policy is ambiguous—one reasonable interpretation is that the occupation requirement must be met at the time the policy issues; another is that it must be met at the time of the loss. Having declared Clause 15 ambiguous, the majority then resolves the ambiguity against the insurer. The majority concludes that Palma, therefore, is a third-party beneficiary even though, at the time she defaulted on the loan, she had long since ceased to live on the premises.

Unlike the majority, I find no ambiguity in Clause 15. It focuses the reader on the relevant time period: "the

borrower shall not be liable to the company for any loss paid to the insured pursuant to this policy." This phrase orients the clause toward the time when the insured suffers a loss. And the earliest such a loss can occur is the date on which the borrower defaults. In sum, I read Clause 15 to give the borrower the right to insist that the insurer waive any right of subrogation against her for any insurance proceeds paid to the insured if, but only if, the borrower occupied the premises at the time of the default. Thus, Palma is not a beneficiary because she did not occupy the premises when she defaulted. Therefore, she has no right to claim a waiver of subrogation.

Even if we assume, however, that this clause is ambiguous as to when the borrower must occupy the premises, I would still conclude that Palma is not a third-party beneficiary. Texas law requires that one claiming to be a third-party beneficiary establish that the parties to the contract clearly intended to benefit her. In *Corpus Christi Bank & Trust* v. *Smith*, 525 S.W.2d 501, 503-04 (Tex. 1975), the Texas Supreme Court summarized this well-established rule as follows:

> The intention of the contracting parties is of controlling significance to a determination that a third party may enforce the contract provision. In deriving intent, we must begin with the presumption that parties contract for themselves, and a contract will not be construed as having been made for the benefit of third parties unless it clearly appears that such was the intention of the contracting parties. (citations omitted). Contrary to the majority's conclusion, Palma cannot bootstrap a finding of third-party beneficiary status from an ambiguous provision. The contract must clearly demonstrate that the parties intended to benefit her.

Republic National Bank v. *National Banker's Life Insurance Co.*, 427 S.W.2d 76 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.), relied upon by the majority, does not purport to announce a different rule. In that case, an

intermediate Texas court stated the third-party beneficiary rule as follows: "Where a stranger contends that it was intended that the provisions of a contract should inure to his benefit such intention must be clearly apparent. If there is any doubt concerning the intent in this regard as it appears from the contract itself, such doubt should be construed against such intent." *Id.* at 80. A stranger to a contract is one who is not a party to the contract. As evidenced by her efforts to achieve third-party beneficiary status, Palma was not a party to this insurance contract between Verex and City Federal. If there is any lingering doubt on this point, the Texas cases interpreting mortgage guaranty insurance policies unanimously hold that a borrower is not a party to such contracts. *Pineda* v. *PMI Mortgage Ins. Co.*, 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992), *writ denied per curiam*, 851 S.W.2d 191 (Tex. 1993); *Shields* v. *Atlantic Fin. Mortgage Corp.*, 799 S.W.2d 441, 444 (Tex. App.—El Paso 1990, no writ); *Hunt* v. *Jefferson Savings & Loan Assoc.*, 756 S.W.2d 762, 765 (Tex. App.—Dallas 1988, writ denied), *cert. denied*, 489 U.S. 1079, 109 S.Ct. 1532, 103 L.Ed.2d 837 (1989).

In conclusion, because Palma was not occupying the premises at the time the insured suffered the loss, Palma cannot clearly establish that she is a third-party beneficiary of Clause 15. And, without third-party beneficiary status, Palma may not claim the benefit of the policy's waiver of subrogation clause. I would therefore affirm the district court's judgment.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

CIVIL ACTION NO. H-91-2390

[Entered: September 21, 1994]

NANCY ABSHIRE PALMA, PLAINTIFF,

V.

VEREX ASSURANCE, INC., DEFENDANT

FINAL JUDGMENT

In accordance with the Magistrate Judge's Memorandum and Recommendation of March 3, 1994, recommending that Defendant's Motion for Partial Summary Judgment be granted as to certain of plaintiff's claims (Docket Entry No. 96), which the court adopted on May 2, 1994 (Docket Entry No. 105); and the Magistrate Judge's Memorandum and Recommendation of July 26, 1994, recommending that Defendant's Motion for Summary Judgment be granted as to all of plaintiff's remaining claims except one (Docket Entry No. 113), which the court adopted on September 21, 1994 (Docket Entry No. 121); the stipulations of the plaintiff, and the court's findings of fact and conclusions of law announced in open court today, all claims asserted by plaintiff, Nancy Abshire Palma, against defendant, Verex Assurance Inc., are DISMISSED with prejudice; and the court ADJUDGES that Verex Assurance Inc. recover from Nancy Abshire Palma, the sum of $ 419,898.12, which is comprised of the principal balance of $ 115,825.14 due under the note, prejudgment interest of $ 78,322.98, ard attorneys fees of $ 225,750.00, together with post-judgment interest at the rate of 6.06% per annum from the date of entry of this judgment on its counterclaim.

This is a **FINAL JUDGMENT.**

SIGNED at Houston, Texas, this 9th day of November, 1994.

/s/ Sim Lake
SIM LAKE
UNITED STATES DISTRICT JUDGE

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action H-91-CV-2390

November 9, 1994, 8:30 a.m.

NANCY ABSHIRE PALMA, PLAINTIFF,

versus

VEREX ASSURANCE, INC., DEFENDANT

VEREX ASSURANCE, INC., COUNTER-CLAIMANT

versus

NANCY ABSHIRE PALMA, COUNTER-DEFENDANT

TRIAL

BEFORE THE HONORABLE SIM LAKE
UNITED STATES DISTRICT JUDGE

Court Reporter:

Willa J. Faris, R.P.R.
Official Court Reporter
United States District Court
515 Rusk, Suite 8016
Houston, Texas 77002
(713) 250-5034

Proceedings recorded by stenotype, transcript produced by computer-aided transcription.

APPEARANCES:

FOR THE PLAINTIFF AND COUNTER-DEFENDANT:

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THE COURT: Good morning, ladies and gentlemen, please be seated.

Civil Action H-91-2390, Nancy Abshire Palma, plaintiff and counter-defendant, versus Verex Assurance, Inc., defendant and counter-plaintiff.

Will counsel please identify themselves and their clients.

MR. BRYAN: My name is Jerry Bryan, I'm representing Nancy Palma.

THE COURT: Thank you.

MR. KIRKMAN: My name is Bill Kirkman. I'm here with Jackie Scott, and our client representative is Tom Anderson.

THE COURT: Thank you. Are all parties ready to proceed?

MR. BRYAN: We are.

MR. KIRKMAN: Verex is ready.

THE COURT: I have re-read the file and read the instruments that you filed within the last week. If you wish to make any opening arguments you can, but to the extent my mental abilities allow me to be prepared, I am prepared as to the file.

So Mr. Bryan, you may proceed either with a brief opening argument, or to call your first witness.

MR. BRYAN: Your Honor, if -- I'm sorry if I don't understand the procedures, I thought we were at this point in time going to get into the admissibility of the documents.

THE COURT: We're going to, since there are objections filed I'm going to treat the objections as contested matters, and if and when the objections are offered I will entertain the objections to them. I do that, because oftentimes the objections can not be ruled upon with some foundation or with some relevance established by oral

evidence, so that's the procedure we're going to follow, notwithstanding what the local rules may say.

MR. BRYAN: In that case I will make a brief opening statement.

THE COURT: All right.

MR. BRYAN: It's my understanding that we are here on I guess a defense and a claim of wrongful foreclosure by Nancy Abshire Palma as to the claim of Verex Assurance, Inc. against her, and I guess the crux of this matter, what would go to the heart of this matter is the irregularity of the foreclosure sale, or an irregularity of the foreclosure sale, which we say was Verex Assurance, Inc.'s failure to bid the full amount of the debt, and that we believe that the adequate bid price was a price set by the state, mandated by the state and that any bid less than the full amount of the debt is an inadequate bid price, and that will be the basis of this claim.

THE COURT: All right. Well, let me ask you a couple of questions. I noted that in Miss Palma's response to Verex's First Request for Admissions, in response to Request for Admission 14, which asks, quote, admit that the note was accelerated according to the terms of the note, comma, deed of trust, comma, and the applicable laws of the State of Texas, Miss Palma's response was "admit."

And then in Request for Admission Number 15 which states, quote, admit that the property was posted for foreclosure, and was foreclosed upon in accordance with the note, deed of trust and Texas Property Code, the response was also "admit."

I take it from those admissions and from the argument that I have just heard you make, that you are not contending that there was any procedural irregularity in the manner in which the property was noticed for foreclosure or was sold, your argument is that the procedural irregularity, to the extent that one exists, arises because the lending institution First

City did not bid in the full amount, which you contend it was obligated to do under its contract with Verex, is that correct?

MR. BRYAN: Everything except the last part of it, your Honor. We believe that they were are obligated because it was a state mandated form, and because they could only use those forms, and that those forms constitute public policy in the State of Texas.

THE COURT: All right. You have two arguments as to procedural irregularity, one, you claim that Verex was obligated by its contract with First City, and First City was obligated under that under that contract to bid in the full deficiency price, and then you have claimed that the failure of First City to bid in the full deficiency price violated public Policy of Texas, is that correct?

MR. BRYAN: Yes.

THE COURT: But as to the manner in which the notice of foreclosure and the foreclosure themselves was conducted under Texas real property law, you are not claiming any irregularity.

MR. BRYAN: We are not.

THE COURT: All right.

MR. BRYAN: Like I said, we are saying that if a lender chooses to recover proceeds under a policy, a private mortgage insurance, at that time, issued at that time, prior to 1984, there was an additional requirement that they had to meet, which was that they had to bid the full amount of the debt at the foreclosure.

THE COURT: All right, I understand your arguments, and I understand the defendant's position on those arguments.

All right. You may proceed.

* * *

THE COURT: Well I'm not -- I mean you haven't introduced any evidence that supports your construction of

paragraph 10. Verex has introduced evidence through this witness which is consistent with the language of paragraph 10 and the policy as a whole, and I find under Federal Rule of Civil Procedure 52 that the language of paragraph 10 and of the policy does not require Verex, does not require the lender to pay as its bid at a foreclosure sale the full amount of the loan.

All right. Go ahead. Proceed.

MR. BRYAN: Your Honor, may I continue to question?

THE COURT: I further -- yes, while I'm on it, I further conclude as a matter of law under Rule 52 that paragraph 10 does not create any private rights to Miss Palma, consistent with Judge Johnson and my prior rulings in this case.

* * *

THE COURT: Pursuant to Federal Rule of Civil Procedure 52, I make the following additional findings of fact and conclusions of law. Since I have already made one finding of fact and one conclusion of law, I will begin the numbering with Two.

Finding of Fact Two: The amount of cash bid at the foreclosure was not grossly inadequate, as compared to the $44,000 market value of the condominium at 4910 Feagan, Houston, Texas, at or shortly before the foreclosure, as reflected by the market value shown in defendant's Exhibit Number "21" of $44,000.

Three: The foreclosure sale was conducted in a commercially reasonable manner, and in accordance with Section 51.002 of the Texas Property Code. There were no irregularities in the foreclosure sale of the property.

Four: The amount of the indebtedness owed by Palma under the mortgage note immediately before the foreclosure was $148,558.88.

Five: The proceeds received from the substitute trustee's sale to be credited to the mortgage note was $30,800.

Six: The deficiency debt due and owing by Palma, after applying all lawful and proper credits, is $115,825.14, as of May 3rd, 1988, with contractual interest accruing thereon at the rate of 10.375 percent per annum.

Seven: Plaintiff is not a third party beneficiary of paragraph 15 of the policy between Verex and its insured, and even if plaintiff were a third party beneficiary of that policy, paragraph 15 would provide no benefits to plaintiff in this case, because plaintiff did not occupy the dwelling at 4910 Feagan either at the time of the plaintiff's default or at the time of the foreclosure.

Eight: Verex is the assignee of the deficiency claimed, and has the right to recover it under the lawful assignment with Palma's lender.

Nine: Plaintiff has not established that Verex or City Federal deliberately chilled the bidding by plaintiff or by any potential buyer at the foreclosure sale.

I have reviewed carefully the Charter National Bank case and the Pentad Joint Venture case. Those cases, one which found a chilling and one which did not, clearly required intentional conduct by the lender or by someone such as Verex associated with a vendor to chill participation by the mortgagee or some third party at the foreclosure sale.

Plaintiff offered evidence of one proposed sale of her home, but there was absolutely no evidence of any interference by Verex or City Federal with either that prospective buyer, any other prospective buyer, or plaintiff, insofar as their rights to bid at the foreclosure sale.

Ten: Verex has necessarily and reasonably incurred attorney's fees in the amount of $225,750 in pursuing it's claim against Palma.

Eleven -- excuse me, continuing with Ten.

All of Verex's attorneys fees arose out of the same matter, and involved the same facts, and were so interrelated with the prosecution of plaintiff's claims against Verex and Verex's counterclaim against plaintiff as to be recoverable.

I note in particular upon reviewing Judge Pecht's March 3rd, 1994, memorandum and recommendation, it's very clear that plaintiff alleged these various claims as defenses to Verex's suit on the note. For example, at page 5 of the opinion, beginning under subparagraph "B", Judge Pecht, now Judge Johnson states, quote, plaintiff alleges that plaintiff can not sue under the terms of the promissory note because the assignment from City Federal to Verex was contrary to law and against public policy.

The same analysis permeates both of Judge Pecht's memorandum and order granting Verex's motion for Summary Judgment. It's clear that plaintiff's against Verex were not only the basis of a recovery by Verex sought -- excuse me a recovery sought by plaintiff against Verex, but were also intended to defeat Verex's deficiency claim against plaintiff.

Eleven: Pre-judgment interest is due in this case in the amount of $78,322.98 from May 4th, 1988, until today.

Conclusions of law.

Two: Palma has waived the right to a jury trial, pursuant to Rules 38-D and 81-C of the Federal Rules of Civil Procedure.

Three: Verex and City Federal did not conspire to bid a grossly inadequate amount at the foreclosure.

Four: An inadequate consideration received at a foreclosure sale is not enough as a matter of law to invalidate the foreclosure under facts such as these, where there was no intention of chilling by the lender.

Five: The foreclosure sale of plaintiff's dwelling did not violate the public policy of Texas.

I note that all of the cases cited by plaintiff involve either policy as expressed in a statute, or as expressed in a particular rule or regulation of the state of Texas.

Plaintiff's public policy argument is not grounded on such an articulated policy, it is grounded on plaintiff's argument quoting from the first page of plaintiff's response to Verex's post trial pretrial -- didn't make much sense, but that's what it's called, response to Verex's post-pretrial of position which says, quote, the intent of the language mandated by the Board in paragraphs 10 and 15 of policy is clear. It is a belt and suspenders approach to making sure that a defaulted borrower already down on his or her luck will not be subjected to further claims from the lender or the private mortgage insuror.

As I have already stated, I don't find that the intent of paragraphs 10 and 15 as manifested by their language supports the interpretation given either of them by the plaintiff, nor am I inclined to find public policy by implication from comparing two paragraphs, which I conclude do not have the meaning which plaintiff ascribes to them.

Lastly, in a case such as this, as I have already stated under Veale versus Rose, the general rule, although only permitting recovery of attorneys fees for a breach of contract also permits recovery of fees incurred in defending against the plaintiff's claim if they were necessary for the counter-claimant to recover and arose out of the same transaction, where the same facts required to prosecute the claim are required to defend against the counterclaim.

To the extent that any Finding of Fact of the Court is more properly characterized as a Conclusion of Law, it is adopted as such. To the extent that any Conclusion of Law of the Court is more properly characterized as a finding of fact, it is adopted as such.

The Court will enter judgment that plaintiff take nothing, and that Verex recover the sum of the deficiency, pre-judgment interest and its attorneys fees.

This trial is adjourned, and once counsel have assisted my law clerk in the marshalling of the exhibits counsel are excused.

* * *

I certify that the foregoing is a correct transcript from the record of proceedings in the above matter.

/s/ Willa J. Farris Date: November 14, 1994
Signature of Court Reporter

APPENDIX D

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

Civil Action H-91-2390

[Entered: September 21, 1994]

NANCY ABSHIRE PALMA, PLAINTIFF,

v.

VEREX ASSURANCE, INC., DEFENDANT

ORDER

The court has reviewed the Magistrate's Memorandum and Recommendation regarding defendant's motion for summary judgment on plaintiff's remaining claims and plaintiff's motion for certification of class (Docket Entry No. 113), the objections of the plaintiff thereto (Docket Entry No. 115), plaintiff's Objections and Response to Court's Order Dated August 17, 1994 (Docket Entry No. 118), plaintiff's Brief in Support of Objections and Response to Court's Order Dated August 17, 1994 (Docket Entry No. 119), and Verex"s Reply to Plaintiff's objections to the Court's Order Dated August 17, 1994 (Docket Entry No. 120). Having considered the arguments of plaintiff in these various papers the court concludes that the memorandum and recommendation of the magistrate judge should be adopted by this court.[1] The court

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[1] The court finds no support in the record for the plaintiff"s argument that the magistrate judge failed to consider Plaintiff's, Response to Defendant's Motion for Summary Judgment (Docket Entry No. 110). In fact at page 13 of the Memorandum and Recommendation the magistrate judge cited to page 48 of plaintiff's response (although the magistrate judge incorrectly referred to it by Docket Entry No. 112, instead of Docket Entry No. 110).

is not persuaded by plaintiff's argument that § 362 of the Bankruptcy Code stays plaintiff's claims against defendant. By its express terms that statute operates to stay only actions brought against a debtor. It does not prohibit the enforcement of an action by the debtor. 11 U.S.C. § 362(a).

Accordingly, the Memorandum and Recommendation of Magistrate Judge Nancy K. Johnson (Docket Entry No. 113) is ADOPTED by this court. Plaintiff's only remaining claim is her claim for wrongful foreclosure. The parties are ORDERED to prepare and file the joint pretrial order on that claim, and to deliver a copy to chambers, by October 12, 1994. Docket call on that claim will be held on October 14, 1994, at 4:00 p.m., in Court Room 9-B, 9th Floor, United States Courthouse, 515 Rusk Avenue, Houston, Texas.

The filing of plaintiff's bankruptcy action operates to stay Verex's counterclaim against plaintiff. Accordingly, defendant's counterclaim against plaintiff is DISMISSED without prejudice. Verex may reinstate its counterclaim within 30 days of the discontinuance of the stay pursuant to 11 U.S.C. § 362(c)(2) if the counterclaim is not discharged.

SIGNED at Houston, Texas, this 20th day of September, 1994.

/s/ Sim Lake
SIM LAKE
UNITED STATES DISTRICT JUDGE

APPENDIX E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action H-91-2390

[Entered: July 26, 1994]

NANCY ABSHIRE PALMA, PLAINTIFF,

v.

VEREX ASSURANCE, INC., DEFENDANT

MEMORANDUM AND RECOMMENDATION

The following motions are now pending before the Court: Plaintiff's Motion for Certification of Class (Docket Entry #39); Defendant's Motion for Protective Order (Docket Entry #64); Defendant's Motion for Oral Hearing (Docket Entry #78); Defendant's Motion for Clarification and Correction of Response Date (Docket Entry #85); Plaintiff's Motion for Leave to Supplement Plaintiff's Objections to Memorandum and Recommendation (Docket Entry #101); Defendant's Motion to Compel Discovery and for Sanctions (Docket Entry #104); Defendant's Motion for Summary Judgment on Plaintiff's Remaining Claims (Docket Entry #108); and Plaintiff's Motion for Oral Hearing, Motion for Relief from Order, Motion for Reconsideration, and Motion for Suspension of Rulings on Dispositive Motions (Docket Entry #111).

All pretrial matters were referred to the undersigned magistrate judge pursuant to 28 U.S.C. § 636(b)(1) and the Cost and Delay Reduction Plan under the Civil Justice Reform Act. After a careful review of the pending motions and all responses thereto, this Court makes the following rulings and recommendations.

The Court makes the following rulings on the non-dispositive motions listed above: Defendant's Motion for Protective Order (Docket Entry #64) is hereby GRANTED; Defendant's Motion for Oral Hearing (Docket Entry #78) is MOOT; Defendant's Motion for Clarification and Correction of Response Date (Docket Entry #85) is MOOT; Plaintiff's Motion for Leave to Supplement Plaintiff's Objections to Memorandum and Recommendation (Docket Entry #101) was rendered MOOT by the Order Adopting Magistrate's Memorandum and Recommendation signed April 6, 1994; Defendant's Motion to Compel Discovery and for Sanctions Docket Entry #104) is hereby DENIED[1]; Plaintiff's Motion for Oral Hearing, Motion for Relief from Order, Motion for Reconsideration, and Motion for Suspension of Rulings on Dispositive Motions (Docket Entry #111) is hereby DENIED.

After reviewing the pending dispositive motion, the record, and the applicable law, this Court RECOMMENDS that Defendant"s Motion for Summary Judgment on Plaintiff's Remaining Claims (Docket Entry #108) be GRANTED, with Plaintiff's claim regarding the foreclosure sale remaining. With respect to this remaining claim, this Court RECOMMENDS that Plaintiff's Motion for Certification of Class (Docket Entry #39) be DENIED.

I. CASE BACKGROUND

On November 28, 1983 Plaintiff borrowed $121,300 from City Federal Savings & Loan ("City Federal") to purchase a condominium. Sonzogni Aff. Exh. 1. As a condition of the loan, Plaintiff was required to purchase mortgage insurance to protect City Federal from loss in the

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[1] Defendant's motion to compel is DENIED at this time because it seeks information which does not survive this Recommendation. Defendant"s motion for sanctions is also DENIED.

event of default. The mortgage insurance was purchased by City Federal from Verex.

Plaintiff lived in the condominium until November of 1986, when she moved out of the property and used it as rental property. *See* Affidavit of W.L. Kirkman, Partial Transcript of Class Cert. Hearing, at 26. In 1988, Plaintiff defaulted on her obligation to repay the borrowed funds. After the default, City Federal foreclosed on the condominium held as security to protect City Federal from nonpayment.

On May 3, 1988, the property was sold at public auction at the Courthouse of Harris County, Houston, Texas. Sonzogni Aff. at 5. The total sales price received was $30,800. *Id.* After foreclosure and applying all credits, there remained a principal balance of $115,825.14 due and owing to City Federal under the terms of Plaintiff's note, which has accrued and which continues to accrue interest from and after May 3, 1988 at the rate of 10.375% per annum. *Id.* at 5.

After Plaintiff had defaulted on the note and City Federal foreclosed, City Federal filled a claim for payment under the mortgage guaranty insurance policy ("Policy") issued by Verex. In June of 1989, City Federal received $51,122.47 as loss payment from the Policy on or about June, 1989. Witkowski Aff. Exh. 7. City Federal then assigned to Verex its rights to pursue a deficiency under the note. The agreement between City Federal and Verex stated in part:

> 1. As a condition precedent to Verex's paying any claims, and upon receipt of such Payment Insured, as to such Loan, grants, assigns, and transfers to Verex all of its rights, title, and interest in the Note, related Loan documents, and any deficiency judgment or rights to obtain such judgment....

Witkowski Aff. Exh. 8.

On April 1, 1991, Defendant Verex, as subsequent assignee of City Federal, demanded Plaintiff repay $117,521.98 as the "deficiency balance due." This amount included accrued interest and costs of foreclosure, as well as a credit for the proceeds received from the foreclosure of the condominium. The amount demanded did not include a credit for the proceeds received from the mortgage guaranty insurance policy.

Plaintiff instituted this suit for damages based on Verex's alleged wrongful conduct in pursuit of the deficiency. Plaintiff's claims for relief and defenses to counterclaims raised in her First Amended Complaint (Docket Entry #28) include: (1) lack of standing; (2) civil conspiracy; (3) breach of contract; (4) insurance benefits; (5) estoppel; (6) violations of the Fair Debt Collection Act; (7) violations of the Deceptive Trade Practices Act; (8) violations of the Credit Reporting Act; (9) usury; (10) illegal assignment; (11) waiver; (12) unjust enrichment; and (13) failure to give lawful offsets and credits. Plaintiff seeks additional relief on the following theories in her First Supplemental Complaint: (1) unreasonable collection efforts at common law; (2) fraud and extortion; (3) violations of the Texas Insurance Code; (4) violations of the Deceptive Trade Practices Act ("DTPA"); and (5) violations of the Texas Debt Collection Act.

Verex filed a counterclaim to recover the deficiency due under the insured mortgage loan. Verex also filed a motion for summary judgment which did not address any of Plaintiff's asserted affirmative defenses against the deficiency recovery which were not based upon, or unique to, the mortgage insurance policy, i.e., Plaintiff's claims related to the foreclosure procedures. Verex's counterclaim was not the subject of its motion for partial summary judgment.

This Court's Memorandum and Recommendation signed March 2, 1994 (Docket Entry #96) and adopted by the District Judge on April 6, 1994 (Docket Entry #105) granted summary judgment on several of Plaintiff's claims. The

following claims and defenses have survived Verex's motions for summary judgment to date: (1) violations of the State and Federal Debt Collection Practices Acts; (2) unreasonable collection efforts at common law; (3) violations of the Credit Reporting Act; (4) violations of the Texas Deceptive Trade Practices Act (DTPA); (5) estoppel and waiver; (6) usury; and (7) failure to give lawful offsets and credits--foreclosure. Verex has filed the instant motion for summary judgment in order to dispose of all but one of these remaining claims.

II. ANALYSIS

A. Summary Judgment Standard

In order to be entitled to summary judgment, the moving party must establish the absence of any genuine issue of material fact. *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 325 (1986). Applicable substantive law determines what factual issues are material. *Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

Federal Rule of Civil Procedure 56(c) sets forth the types of evidence which may be considered when reviewing a motion for summary judgment. That evidence includes pleadings, depositions, answers to interrogatories, admissions on file, and affidavits.

Evidence used by the non-moving party to avoid summary judgment need not be in a form that would be admissible at trial. *Celotex*, 477 U.S. at 324. However, Fed. R. Civ. P. 56(e) does require that affidavits opposing summary judgment be made on personal knowledge and set forth facts which would be admissible in evidence. Facts contained in affidavits which would not be admissible in evidence must be excluded from consideration for summary judgment purposes.

When considering the evidence submitted in support and opposition to a motion for summary judgment, the Court must draw all reasonable inferences from the underlying facts in

favor of the non-moving party. *Anderson*, 477 U.S. at 225; *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962). All doubt as to the existence of a genuine issue of material fact must also be resolved in favor of the non-movant. *Hayden* v. *First National Bank of Mt. Pleasant, Texas*, 595 F.2d 994, 996-97 (5th Cir. 1979).

B. State And Federal Debt Collection Practices Acts

Plaintiff alleges that the following actions of Defendant violate "one or more of the provisions of federal and state statutes governing Fair Debt Collection practices"[2]: (a) Defendant falsely represented itself as a legal assignee of the promissory note from the bank; (b) Defendant knowingly demanded the incorrect balance of the debt by failing to give proper offsets and credits; (c) Defendant mischaracterized the claims against Plaintiff as a loan deficiency; (d) Defendant knowingly communicated false information about Plaintiff's debt to others, including credit reporting agencies; (e) Defendant implied that it was an innocent purchaser for value entitled to the rights afforded a *bona fide* purchaser; and (f) "[I]n its collection activities under the Assignment Agreement, Verex misrepresented the character and extent of the debt sought to be collected and has made use of the U.S.

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[2] Plaintiff relies upon TEX. REV. CIV. STAT. ANN. art. 5069-11.02(h) (Vernon 1987), which prohibits a debt collector from "threatening to take any action prohibited by law," and TEX. REV. CIV. STAT. ANN. art. 5069-11.05(g) (Vernon 1987), which provides that no debt collector may attempt to collect a debt by any fraudulent, deceptive, or misleading representations with respect to the character, extent, or amount of a debt against a consumer. Although Plaintiff does not cite the Federal Debt Collection Practices Act, it appears she attempts to allege a violation of 15 U.S.C.A. § 1692e(2)(A) (West 1982), which prohibits a debt collector from falsely representing the character, amount, or legal status of any debt in connection with the collection of any debt.

Mail to further its fraudulent collection scheme." *See* Pl.'s Am. Compl. at 5-6; Pl.'s Supp. Compl. at 20.

The Court has already determined that Texas case law does not support Plaintiff's contention that the assignment in the instant case was illegal (*See* Docket Entry #96 at 6); thus, Plaintiff cannot rely on this theory as a basis for violation of the Texas and federal debt collection practices acts. In addition, the Court has already determined that Plaintiff was not entitled to any offset or credit for the private mortgage insurance coverage provided by Defendant Verex (*See Id.* at 10); therefore, Plaintiff cannot rely upon her "offset" or "credit" theory as a basis for violation of the Texas and federal debt collection practices acts.

In light of the foregoing, Plaintiff's assertion that Defendant has mischaracterized the legal status of the debt as a loan deficiency is without merit. Further, Plaintiff's claim that Verex "misrepresented the character and extent of the debt sought to be collected" is merely a restatement of the claims previously discussed.

Plaintiff's claim that Defendant "implied" that it was an innocent purchaser for value entitled to the rights afforded a *bona fide* purchaser also lacks merit. Plaintiff has not referred the Court to any document or conversation where Defendant characterized itself as a *bona fide* purchaser. In fact, in the letter sent to Plaintiff on April 1, 1991, Defendant clearly states that it had "been assigned all rights in the original note ..." Pl. Dep. Ex. 13. Defendant further states that "As an assignee, [Defendant] has rights to recover this outstanding deficiency." *Id.* A clear reading of this letter indicates that Defendant is seeking only to assert its rights as an assignee. Furthermore, the term *bona fide* purchaser would not even apply to the transaction in the instant case.

A *bona fide* purchaser is one who has acquired apparent legal title to property in good faith, for a valuable consideration, and without actual or constructive notice of any

outstanding equity, adverse interest, or title. *Clark* v. *Snider*, 738 S.W.2d 49, 52 (Tex. App.—Texarkana 1987, no writ); *Carter* v. *Converse*, 550 S.W.2d 322, 329 (Civ. App.—Tyler 1977, writ ref'd n.r.e.). In the instant case, Defendant did not acquire title to property; instead, Defendant acquired an interest in a note,[3] which is a negotiable instrument. As a transferee of a negotiable instrument, Defendant could potentially be classified as a holder in due course, not a *bona fide* purchaser.

The benefit of holder in due course status is that when an innocent party, or holder in due course, acquires a negotiable instrument, he takes it free from all personal defenses.[4] *NCNB Texas National Bank* v. *Campise*, 788 S.W.2d 115, 118 (Tex. App.—Houston [14th Dist.] 1990, writ denied). Plaintiff apparently argues that Verex does not have the right to pursue the deficiency because it was on notice of Plaintiff's claimed defenses, and therefore would not qualify for the protection afforded a holder in due course. However, Defendant did not have to qualify for holder in due course status to acquire the rights of City Federal. TEX. BUS. & COM. CODE ANN. § 3.201 (Vernon 1968), provides that: "[t]ransfer of an instrument vests in the transferee such rights as the transferor has therein...." Section 3.201 applies to any transfer, whether by a holder or not. *Id.* cmt. 1. Section

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[3] The assignment agreement between City Federal and Verex states that City Federal "grant[ed], assign[ed], and transfer[red] to Verex all of its rights, title, and interest in the Note, related Loan documents, and any deficiency judgment or rights to obtain such judgment." Sonzogni Aff. Ex. 7.

[4] "Personal defenses, such as failure of consideration and usury, are not truly defenses against the note itself, but rather, are defenses or claims stemming from the underlying transaction." *NCNB Texas National Bank* v. *Campise*, 788 S.W.2d 115, 118 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

3.201 applies to all transferees regardless of whether the transferees are holders. *Pineda* v. *PMI Mortgage Ins. Co.*, 843 S.W.2d 660, 669 (Tex. App.—Corpus Christi 1992, writ denied) (citing *Campise*, 788 S.W.2d at 118). Therefore, whether Verex qualifies as a holder in due course or not, Verex has all the rights that City Federal had to pursue the deficiency under the note, and Verex did not misrepresent that it was a *bona fide* purchaser of the property.

The only remaining basis for Plaintiff's debt collection practices acts claims is Plaintiff's allegation that Defendant knowingly communicated false information about Plaintiff's debt to others. This allegation also provides the basis for Plaintiff's Credit Reporting Act claim, so the Court will consider these claims concurrently. Plaintiff generally alleges that Defendant's conduct violated a credit reporting law without citing any statutory authority.

Plaintiff vaguely alleges that Defendant knowingly reported incorrect information about Plaintiff's debt to one or more credit reporting agencies. Plaintiff further contends that the amount of the true deficiency was greatly exaggerated. Also, Plaintiff asserts that Defendant did not explain the owner and nature of the debt, thereby violating the laws governing credit reporting.

First, there is evidence that Verex provided information regarding Plaintiff's debt to CSC, a credit bureau. Pl. Dep. at 79 (Docket Entry #17, Ex. 5). Plaintiff knows of no other agency to which that information was reported. *Id.* at 110. Harbor Financial Mortgage refused Plaintiff's request for a home loan in April of 1991 because the credit report provided by CSC reflected that she owed Verex $117,000. *Id.* at 50, 79. Plaintiff testified that she did not owe Verex $117,000 because she was entitled to a credit for the mortgage insurance proceeds, and she did not believe that Verex was the legal assignee of the note.

This Court has already determined that Plaintiff was not entitled to a credit for the mortgage insurance proceeds, and that Verex was the legal assignee of the note. Therefore, these bases for Plaintiff's Debt Collection Act and Credit Reporting Act claims are without merit.

Second, Plaintiff admitted that on April 1, 1991, she received a demand letter from Verex, and that by reading such letter she could determine that Verex was claiming that she owed them $117,000 through an assignment from City Federal. *Id.* at 110. Therefore, Plaintiff's claim that Defendant did not disclose the owner and nature of the debt is meritless.

After examining the bases of Plaintiff's Debt Collection Practices Act and Credit Reporting Act claims, the Court concludes that Defendants did not threaten any action prohibited by law, nor did they misrepresent the character, extent, or amount of Plaintiff's debt to anyone. This Court RECOMMENDS that summary judgment be GRANTED as a matter of law as to Plaintiff's Texas and Federal Debt Collection Practices Act and Credit Reporting Act claims because Defendant is entitled to judgment as a matter of law.

C. Unreasonable Collection Efforts at Common Law

Plaintiff alleges that Verex's actions constituted unreasonable collection efforts against Plaintiff in the following particulars, based upon Plaintiff's "information and belief":

a) Verex knew that such collection efforts were in violation of its own policy terms and in violation of its representations to the State Board of Insurance;

b) Verex knew that its scheme against the purchasers would be in violation of the DTPA, the Texas Debt Collection Act, the Texas Insurance Code, and other civil and criminal state statutes; and

c) Verex was aware of the personal vulnerability of the purchasers and intended to use that vulnerability to its advantage.

When an individual incurs a debt, the person or entity to whom the debt is owed is entitled to use reasonable efforts to collect that debt. *Whatley* v. *K-Mart Discount Stores*, 451 S.W.2d 568 (Tex. Civ. App.-Houston 1970, writ ref'd n.r.e.). Further, even if the debt were usurious, as alleged in the instant case, the Texas Supreme Court has refused to hold that by using reasonable efforts to collect a usurious debt a creditor runs the risk of liability for damages. *Ware* v. *Paxton*, 359 S.W.2d 897, 900 (Tex. 1962).

Although the Texas Supreme Court has not expressly defined the parameters within which a creditor is confined in making reasonable efforts to collect debt without risking liability, it has found that a "resort to every cruel device which his cunning can invent in order to enforce collection when that course of conduct has the intended effect of causing great mental anguish to the debtor, resulting in physical injury and causing his loss of employment, renders the creditor liable to respond in damages." *Duty* v. *General Finance Company*, 154 Tex. 16, 20, 273 S.W.2d 64, 66 (1954). It is necessary that the creditor carry on a campaign of harassment in order to entitle a borrower to actual damages for unreasonable collection efforts. *Ware* v. *Paxton*, 359 S.W.2d 897, 900 (Tex. 1962). The categories of conduct which have overwhelmingly supported a finding of unreasonable collection efforts include: telephoning a plaintiff's business fifteen times a day for three months and coming to plaintiff's place of business demanding payment[5]; bombarding plaintiffs with collection letters, telegrams, and telephone calls, at all hours of the day, at their homes and at their places of

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[5] *Moore* v. *Savage*, 359 S.W.2d 95, 96-97 (Tex. Civ. App.—Waco 1962, writ ref'd n.r.e.).

employment, and using "nasty, harsh and loud" tones and sometimes implied threats.[6]

The Court agrees with Plaintiff when she states that "[t]he gist of the action [for unreasonable collection efforts] is the unreasonableness of the creditor's efforts under the facts and circumstances of the individual case." Pl. Response at 48 (Docket Entry #112). In the instant case, Plaintiff has failed to provide the Court with any competent summary judgment evidence that Verex acted unreasonably in attempting to collect the debt at issue from Plaintiff. This Court has extensively reviewed the evidence in the record and has not found any indication that Verex either intentionally or negligently engaged in a "campaign of harassment" which is the essence of this tort.

In fact, Plaintiff has presented into evidence only six letters written by City Federal, the Defendant, or Defendant's subsidiary, Masco, concerning this debt from January 14, 1988 until April 1, 1991. See Pl. Dep. Exs. 4-13. Six letters over the course of approximately three years simply does not rise to the level of a "campaign of harassment," which is essential to establish a cause of action for unreasonable collection efforts. In addition, Plaintiff testified that she initiated a substantial portion of the telephone contact that took place. At no time in her deposition did she ever state that Defendant called her repeatedly or used harsh or threatening terms during their conversations. Pl. Dep. at 36-49.

Plaintiff has failed to come forward with any evidence of conduct rising to the level of harassment necessary to establish a claim for unreasonable collection efforts.

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[6] *Industrial Finance Service Co.* v. *Riley*, 295 S.W.2d 498, 502-503 (Tex. Civ. App.—Dallas 1956), *aff'd in part, rev'd in part*, 157 Tex. 306, 302 S.W.2d 652.

Therefore, this Court RECOMMENDS that summary judgment be GRANTED on this claim.

E. Texas Deceptive Trade Practices Act (DTPA)

Plaintiff alleges that Defendant engaged in unconscionable actions violating the Deceptive Trade Practices Act by alleging that Plaintiff was not entitled to any benefits of the insurance contract, by failing to disclose information concerning goods or services which was known at the time Plaintiff signed the promissory note and agreed to pay the mortgage insurance premiums, and by allowing Plaintiff to pay good and valuable consideration for goods or services which was known at the time Plaintiff signed the promissory note and agreed to pay the mortgage insurance premiums, and by allowing Plaintiff to pay good and valuable consideration for goods or services which were not to be provided. Pl. Supp. Compl. at 6-7 (Docket Entry #28). As discussed below, these three grounds for violation of the Deceptive Trade Practices Act cannot survive summary judgment.

First, this court has already determined that Plaintiff was not entitled to any benefits of the insurance contract, thus Defendant misrepresented nothing. Memorandum and Recommendation at 7-10 (Docket Entry #96, *adopted* by Docket Entry #105). Second, there is no evidence that Plaintiff paid for goods or services which were not provided. In order to obtain her loan, Plaintiff was required to pay the lender's premium for mortgage insurance. The lender was insured by Defendant in the event of Plaintiff's default. It is undisputed that when Plaintiff defaulted, Defendant paid its insured's claim. As previously stated, Plaintiff was not entitled to the benefits or proceeds of the insurance policy, only the insured, City Federal.

Finally, Defendant allegedly violated the Deceptive Trade Practices Act by failing to disclose information concerning goods or services which was known at the time Plaintiff

signed the promissory note and agreed to pay the mortgage insurance premiums. The Deceptive Trade Practices Act declares unlawful any false, misleading, or deceptive acts or practices in the conduct of any trade of commerce. TEX. BUS. & COM. CODE ANN. § 17.46(a) (Vernon 1987). This includes the failure to disclose information concerning goods or services, which was known at the time of the transaction, if such failure to disclose was intended to induce the consumer into a transaction, into a transaction into which the consumer would not have entered had the information been disclosed. TEX. BUS. & COM. CODE ANN. § 17.46(b)(23) (Vernon Supp. 1994). Although neither foreseeability nor reliance are required, if the misrepresentation did not induce the consumer to enter into the contract, there can be no recovery. *See Camden Machine & Tool-Inc.* v. *Cascade Co.*, 870 S.W.2d 304, 311 (Tex. App.-Fort Worth 1993, no writ).

It is clear that the alleged failure to disclose the true nature of the insurance did not induce Plaintiff to enter into the contract. Plaintiff admitted in her deposition that whether the mortgage insurance would pay off the loan if she defaulted was not an issue at the time she entered into the contract because she "didn't even think that far ahead. [She] never intended to default; so, '[she] didn't think of it as an issue." Pl. Dep. at 23. Therefore, this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant on Plaintiff's DTPA claim.

F. Estoppel and Waiver

1. Estoppel

Plaintiff alleges that because she understood that the mortgage insurance that she was required to purchase would compensate City Federal for some or all of the loss it suffered in the event of a loan default, Defendant is estopped from depriving Plaintiff of the economic benefit of the insurance. Plaintiff further asserts that Defendant is estopped from

bringing legal actions and demands against Plaintiff which are prohibited under the contractual arrangements originally entered into by and between Plaintiff, City Federal, and Defendant. Finally, Plaintiff alleges that because of her reasonable reliance on the various agreements, it would be unfair to deprive her of the benefit of the bargain.

Defendant contends that estoppel is not a cause of action, but instead is only a defensive theory. The Court agrees with Defendant that promissory estoppel is normally a defensive theory; however, contrary to Defendant's assertion, Texas court's have permitted plaintiffs to assert promissory estoppel as an affirmative ground for relief. *Wheeler* v. *White*, 398 S.W.2d 93, 97 (Tex. 1965); *Adams* v. *Petrade Int'l Inc.*, 754 S.W.2d 696, 707 (Tex. App—Houston [1st Dist.] 1988, writ denied).

Promissory estoppel is a defensive theory in that it estops the promisor from denying tho enforceability of his promise. A promisee may invoke the doctrine of promissory estoppel "[w]here the promissee has failed to bind the promisor to a legally sufficient contract, but the promisee has acted in reliance on the promise to his detriment." *Wheeler* v. *White*, 398 S.W.2d 93, 97 (Tex. 1965); 34 Tex. Jur. 3d *Estoppel* § 12 (1984). Because the promisee asserting promissory estoppel has failed to bind the promisor to a legally sufficient contract, the promisee is only allowed to recover reliance damages measured by the detriment sustained. *Id.*

In sum, "[t]he doctrine of promissory estoppel is not applicable where there is a valid contract, nor does the doctrine create a contract where none existed, but only prevents a party from denying enforceability of his promise." 34 Tex. Jur. 3d *Estoppel* § 12 (1984).

The elements of promissory estoppel require proof of:

(1) a promise;

(2) foreseeability that the promisee would rely on the promise; and

(3) substantial reliance by the promisee to his detriment.

Adams, 754 S.W.2d at 707 (citing *English* v. *Fischer*, 660 S.W.2d 521, 524 (Tex. 1983)).

Plaintiff has simply failed to provide any proof of the first element required to establish a promissory estoppel claim. Plaintiff has provided no evidence that Defendant made any promises that Plaintiff would be entitled to credit for mortgage insurance proceeds paid upon default. In fact, Plaintiff has admitted that Defendant, Verex, did not make any representations to her before the closing regarding the purpose of or the benefits of the mortgage insurance at issue. Pl. Dep. at 88-89 (Docket Entry #17; Ex. 5) . Any such representations were made by Alpha Mortgage Corporation "and/or the title company.'" *Id.* at 89-90. As the nonmoving party, Plaintiff must "come forward with 'specific facts showing that there is a *genuine issue for trial.*'" *Matsushita Elec. Ind. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986) (emphasis in original). Plaintiff cannot even identify who made the alleged promise.

In addition, Plaintiff cannot satisfy the third element of substantial reliance to her detriment. As cited earlier, Plaintiff admitted in her deposition that she did not rely upon any such promise. Plaintiff testified that she didn't believe that whether the mortgage insurance would pay off the loan if she defaulted was an issue because she "didn't even think that far ahead. [She] never intended to default; so, [she] didn't think of it as an issue." Pl. Dep. at 23.

Therefore, Plaintiff have failed to raise a genuine issue of material fact as to one or more elements of her promissory estoppel claim, and this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant.

2. Waiver

Plaintiff alleges that by virtue of the "no subrogation" clause 15 of the master policy,[7] Defendant has expressly waived any and all rights against Plaintiff for losses sustained by reason of Plaintiff's default on the promissory note.

Waiver is defined as "the intentional relinquishment of a known legal right available at the time, or such conduct as warrants an inference of the relinquishment of the right." 34 Tex. Jur. 3d *Estoppel* § 5 (1984). Waiver is distinguishable from estoppel in the following respect: "Waiver is the voluntary surrender of a right; estoppel is the inhibition to assert it from the mischief that has followed one's own fault." *Id.*

Waiver, by definition, cannot be asserted unless an underlying contract existed which established the rights of each party. There are three ways a party to a Contract may waive a right: (1) the right may be expressly renounced; (2) the party knowingly possessing the right is inactive or silent for such an unreasonable time that the intention to naive is implied; and (3) the party knowingly possessing the right acts in such a manner that the party misleads the opposing party into believing that a waiver has occurred. *KMI Continental Offshore Production Co.* v. *ACF Petroleum Co.*, 746 S.W.2d 238, 243 (Tex. App.—Houston [1st Dist.] 1987, writ denied).

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[7] Condition 15 of the master policy reads:

> NO RIGHT OF SUBROGATION AGAINST BORROWER—The borrower shall not be liable to the Company for any loss paid to the insured pursuant to this policy; provided, however, that the real estate shall consist of a single family dwelling occupied by the Borrower; otherwise, the Company reserves the right to make claim against the Borrower for any loss paid or deficiency suffered by the Company.

In the instant case, the Court has already determined that Plaintiff was neither a party nor a third party beneficiary to the contract at issue. *See* Memorandum and Recommendation at 7-9 (Docket Entry 196) and Order Adopting (Docket Entry #105). Therefore, Verex could not have voluntarily surrendered a legal right under the contract to the Plaintiff because she was not a party or an intended beneficiary of the contracts.[8] Consequently, Plaintiff has failed to raise a genuine issue of material fact as to her waiver claim, and this Court RECOMMENDS that summary judgment be GRANTED.

G. Usury

Plaintiff alleges that Defendant's initial demand for payment of $117,521.98 constitutes Usurious interest on the promissory note. Plaintiff's usury claim is based solely upon her argument that "Verex demands have not given any credit for the insurance proceeds received by the noteholder. Texas does not allow double recoveries." Pl. Brief in Opposition at 9 (Docket Entry #19) (citation omitted). In sum, Plaintiff asserts that if Verex is allowed to receive payment from Plaintiff for a portion of the debt already paid by insurance proceeds to the prior noteholder, double recovery on the debt

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[8] Even if condition 15 were intended to benefit Plaintiff, she did not qualify for its protection because, under a strict construction of its terms, she did not occupy the dwelling for at least one year and seven or eight months prior to foreclosure. See Tr. of Class Cert. Hearing at 26 (Docket Entry #73).

would result.[9] *See* Pl. Memorandum of Points & Authorities at 3 (Docket Entry #20).

The Court has already determined that "no contractual obligation gives Plaintiff Palma a right to an offset for the private mortgage insurance coverage provided by Defendant Verex, and there is no legal requirement for an offset." Memorandum and Recommendation at 10 (Docket: Entry #96, *adopted*, Docket Entry #105). Because Plaintiff's usury claim is based solely upon the faulty premise that she was entitled to an offset for the private mortgage insurance coverage provided by Verex, Plaintiff has failed to raise a genuine issue of material fact as to her usury claim. Therefore, the Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant Verex on this claim.

H. Failure to Give Lawful Offsets and Credits—Foreclosure

The only remaining claim relates to the actual foreclosure on the property. Plaintiff alleges that the Bank conspired to bid at foreclosure a grossly inadequate amount as determined by reputable appraisal information and resale prices. According to Plaintiff, the Bank refused to permit Plaintiff to sell the property immediately prior to foreclosure for an amount which would have resulted in a substantial decrease in the deficiency balance. The Bank resold the real estate in a very brief period for a substantially higher price more closely approximating true market value. Plaintiff alleges that

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[9] Plaintiff has testified that her usury claim is based upon her entitlement to a credit for the mortgage insurance proceeds and that she has no personal knowledge of any other credit she was allegedly entitled to receive. Pl. Dep. at 112 (Docket Entry #17, Ex. 5). Plaintiff has not come forward with competent summary judgment evidence of any other credit to which she is entitled.

as an assignee, Defendant stands in the shoes of the Bank and is charged with full knowledge of these actions.

Defendants did not address this claim in their notion for summary judgment on Plaintiffs remaining claims. Because this claim involves the procedures of the foreclosure sale and is not a mere restatement of Plaintiff's unmeritorious "credit for insurance proceeds" theory, the Court RECOMMENDS that this claim be set for trial in the near future.

In light of the foregoing recommendation, the undersigned further RECOMMENDS that Plaintiff's Motion for Certification of Class (Docket Entry #39) be DENIED. Class certification is inappropriate because the surviving claim relates to the foreclosure of Plaintiff's property and presents facts unique to the Plaintiff. Therefore, Plaintiff has not satisfied the requirements for class certification under Federal Rule of Civil Procedure 23(a) and (b).

III. CONCLUSION

For the foregoing reasons, this Court RECOMMENDS that Defendant's Motion for Summary Judgment on Plaintiff's Remaining Claims (Docket Entry #108) be GRANTED and that Plaintiff's Motion for Certification of Class (Docket Entry 139) be DENIED. Plaintiff's claims regarding the foreclosure procedures, as well as Defendant's counterclaim survive this Recommendation.

The Clerk shall send copies of this Memorandum and Recommendation to the respective parties who have ten (10) days from the receipt thereof to file written objections thereto pursuant to General Order 80-5. Failure to rile written objections within the time period mentioned shall bar an aggrieved party from attacking the factual finding on appeal.

The original of any written objection shall be filed with the United States District Clerk, P.O. Box 61010, Houston, Texas 77208; copies of such objections shall be mailed to

opposing parties and to the chambers of the undersigned, P.O. Box 61167, Houston, Texas 77208.

SIGNED at Houston, Texas this 26th day of July, 1994.

/s/ Nancy K. Johnson

NANCY K. JOHNSON
UNITED STATES MAGISTRATE JUDGE

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

C.A. NO. H-91-2390

[Signed: April 6, 1994]

NANCY ABSHIRE PALMA, PLAINTIFF

v.

VEREX ASSURANCE, INC., DEFENDANT

ORDER ADOPTING MAGISTRATE'S MEMORANDUM AND RECOMMENDATION

The Court has reviewed the Magistrate's Memorandum and Recommendation regarding Plaintiff's Motion for Partial Summary Judgment (Docket Entry #49); Defendant's Motion for Partial Summary Judgment as to Plaintiff's First Amended Complaint and First Supplemental Complaint (Docket Entry #54); Plaintiff's Motion for Sanctions (Docket Entry #59); Plaintiff's Motion for Partial Summary Judgment Entry #68); Defendant's Request for Oral Submission Docket Entry #82); and Plaintiff's Motion for Certification of Class (Docket Entry #39) and the objections thereof and is of the opinion that said Memorandum and Recommendation should be adopted by this Court.

It is, therefore, ORDERED, ADJUDGED and DECREED that Magistrate Judge Nancy K. Pecht's Memorandum and Recommendation is hereby adopted by this Court.

The Clerk shall send copies of this Order to the respective parties.

DONE at Houston, Texas this 6th day of April, 1994.

/s/ Sim Lake
SIM LAKE
UNITED STATES DISTRICT JUDGE

APPENDIX G

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

C.A. NO. H-91-2390

[Entered: March 3, 1994]

NANCY ABSHIRE PALMA, PLAINTIFF,

v.

VEREX ASSURANCE, INC., DEFENDANT

MEMORANDUM AND RECOMMENDATION

Now pending before the Court are the following motions: Plaintiff's Motion for Partial Summary Judgment (Docket Entry #49); Defendants Motion for Partial Summary Judgment as to Plaintiff's First Amended Complaint and First Supplemental Complaint (Docket Entry #54); Plaintiff's Motion for Sanctions (Docket Entry #59); Plaintiff's Motion for Partial Summary Judgment (Docket Entry #68); Defendant's Request for Oral Submission (Docket Entry #82); and Plaintiff's Notion for Certification of Class (Docket Entry #39).

All pretrial matters were referred to the undersigned magistrate judge pursuant to 28 U.S.C. § 636(b)(1) and the Cost and Delay Reduction Plan under the Civil Justice Reform Act. After a careful review of the pending motions and all responses thereto, this court makes the following recommendations.

This Court RECOMMENDS that Plaintiff's Motion for Partial Summary Judgment (Docket Entry #49) be DENIED; Defendant's Motion for Partial Summary Judgment as to Plaintiff's First Amended Complaint and First Supplemental Complaint (Docket Entry #54) be GRANTED IN PART and

DENIED IN PART; Plaintiff's Motion for Sanctions (Docket Entry #59) be DENIED; Plaintiff's Motion for Partial summary Judgment (Docket Entry #68) be DENIED; and Defendant's Request for Oral Submission (Docket Entry #82) be DENIED.

II. CASE BACKGROUND

On November 28, 1983 Plaintiff borrowed $121,300 from City Federal Savings & Loan ("City Federal") to purchase a condominium. Sonzogni Aff. Exh. 1. As a condition of the loan, Plaintiff was required to purchase mortgage Insurance to protect City Federal from loss in the event of default. The mortgage insurance was purchased by City Federal from Verex.

Mrs. Palma lived in the condominium until November of 1986, when she moved out of the property and used it as rental property. *See* Affidavit of W.L. Kirkman, Partial Transcript of Class Cert. Hearing, at 26. In 1988, Palma defaulted on her obligation to repay the borrowed funds. After the default, City Federal foreclosed on the condominium hold as security to protect city Federal from nonpayment.

On May 3, 1988, the property was sold at public auction at the Courthouse of Harris County, Houston, Texas. Sonzogni Aff. at 5. The total sales price received was $30,800. *Id.* After foreclosure and applying all credits, there remained a principal balance of $115,825.14 due and owing to City Federal under the terms of Palma's note, which has accrued and which continues to accrue interest from and after May 3, 1988 at the rate of 10.375% per-annum. *Id.* at 5.

After Plaintiff had defaulted on the note and the City Federal foreclosed, City Federal filed a claim for payment under the mortgage guaranty insurance policy ("Policy") issued by Verex. In June of 1989, City Federal received $51,122.47 as loss payment from the Policy. Witkowski Aff.

Exh. 7. City Federal then assigned to Verex its rights to pursue a deficiency under the note. The agreement between City Federal and Verex stated in part:

> 1. As a condition precedent to Verex's paying any claims, and upon receipt of such Payment Insured, as to such Loan, grants, assigns, and transfers to Verex all of its rights, title, and interest in the Note, related Loan documents, and any deficiency judgment or rights to obtain such judgment ....

Witkowski Aff. Exh. 8. On April 1, 1991, Defendant Verex, as subsequent assignee of City Federal, demanded Plaintiff repay $117,521.98 as the "deficiency balance due." This amount included accrued interest and costs of foreclosure, as well as a credit for the proceeds received from the foreclosure of the condominium. The amount demanded did not include a credit for the proceeds received from the mortgage guaranty insurance policy.

Plaintiff instituted this suit for damages based on Verex's alleged wrongful conduct in pursuit of the deficiency. Plaintiff's claims for relief and defenses to counterclaims raised in her First Amended Complaint (Docket Entry #28) include: (1) lack of standing; (2) civil conspiracy; (3) breach of contract; (4) insurance benefits; (5) estoppel; (6) Fair Debt Collection Act; (7) Deceptive Trade Practices Act; (8) Credit Reporting Act; (9) usury; (10) illegal assignment; (11) waiver; (12) unjust enrichment; (13) failure to give lawful offsets and credits. Plaintiff seeks additional relief on the following theories in her First Supplemental complaint: (1) unreasonable collection efforts at common law; (2) fraud and extortion; (3) violations of the insurance code; (4) violations of the Deceptive Trade Practices Act ("DTPA"); and (5) violations of the Texas Debt Collection Act.

Verex filed a counterclaim to recover the deficiency due under the insured mortgage loan. Verex's counterclaim is not the subject of its motion for partial summary judgment. In

addition, Defendant's motion does not address any of Plaintiff's asserted affirmative defenses against the deficiency recovery which were not based upon, or unique to, the mortgage insurance policy, i.e., claims related to the foreclosure procedures.

II. ANALYSIS

A. Summary Judgment Standard

In order to be entitled to summary judgment, the moving party must establish the absence of any genuine issue of material fact. *Celotex Corp.* v. *Catrett*, 477 U.S. 317, 325 (1986). Applicable substantive law determines what factual issues are material. *Anderson* v. *Liberty* 477 U.S. 242, 248 (1986).

Federal Rule of Civil Procedure 56(c) sets forth the types of evidence which may be considered when reviewing a motion for summary judgment. That evidence includes pleadings, depositions, answers to interrogatories, admissions on file, and affidavits.

Evidence used by the non-moving party to avoid summary judgment need not be in a form that would be admissible at trial. *Celotex*, 477 U.S. at 324. However, Fed. R. Civ. P. 56(e) does require that affidavits opposing *summary* judgment be made on personal knowledge and set forth facts which would be admissible in evidence. Facts contained in affidavits which would not be admissible in evidence must be excluded from consideration for summary judgment purposes.

When considering the evidence submitted in support and opposition to a motion for summary judgment, the Court must draw all reasonable inferences from the underlying facts in favor of the non-moving party. *Anderson*, 477 U.S. at 225; *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962). All doubt as to the existence of a genuine issue of material fact must also be resolved in favor of the non-movant.

Hayden v. *First National Bank of Mt. Pleasant, Texas*, 595 F.2d 994, 996-97 (5th Cir. 1979).

B. Illegal Assignment/Lack of Standing

Plaintiff alleges that Defendant cannot sue her under the terms of the promissory note because the assignment from City Federal to Verex was contrary to law and against public policy. Plaintiff argues that because the assignment to Verex was illegal, Verex lacks standing to enforce any of the terms of the promissory note as between Plaintiff and City Federal.

Texas courts have allowed a private mortgage insurer to sue on an assignment of the loan deficiency claim obtained in settlement of the action with its, insured. *See Cockrell* v. *Republic Mortgage Ins. Co.*, 817 S.W.2d 106 (Tex. App.—Dallas 1991, no writ); *See also Pineda* v. *PMI Mortgage Ins. Co.*, 843 *S.W.*2d 660 (Tex. App.—corpus Christi 1992, writ denied).

In *Cockrell* as in the instant case, the private mortgage insurer paid on the policy and took assignment of the notes. *Cockrell*, 817 S.W.2d at 110. The court upheld the assignment and found that once the Insurer proved its claim as holder of the notes as a matter of law, it was entitled to summary judgment. *Id.* at 113.

In *Pineda*, the court of appeals upheld an assignment which was much the same as the one in the present case. In consideration of PMI's payment of the lender's claim, the lender assigned its rights under the loan documents to pursue claims for the deficiency against the Pinedas. Although the lender's claim was paid by PKI, it did not credit the payment to the loan deficiency. The court found that PMI, the present note holder, did not seek to recover the same deficiency twice by its failure to credit the insurance payment, and upheld the assignment. *Id.* at 665.

Because Texas case law does not support Plaintiff's assertion that the assignment to Verex was illegal, this Court

RECOMMENDS that summary judgment be GRANTED in favor of Defendant.

C. Breach of Contract

Plaintiff asserts that she is a third party beneficiary of the insurance contract between City Federal and Defendant Verex based on the fact that Plaintiff paid the policy premiums. Plaintiff claims that Verex has allegedly breached the contract and damaged Plaintiff by demanding the full amount of deficiency, without decreasing the loan deficiency by the amount of insurance proceeds received by City Federal.

1. Plaintiff's Third Party Beneficiary Theory

The policy of insurance between Verex and its insured, City Federal, on the Palma loan was accomplished by a master policy and separate addendums to the policy for each loan insured. The master policy expressly provided that its provisions would only inure to the benefit of, and be binding upon, Verex, its insured, and its insured's successors and assigns. Witkowski Aff. Exh. 1., Condition 16; *see, e.g.*, *Pineda* v. *PMI Mortgage Ins. Co.* 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992, writ denied).

In *Pineda*, as in the instant case, the deed of trust required the Pinedas to pay to the original noteholder in monthly installments, one-twelfth of the yearly premium for mortgage insurance. The Pinedas argued that they were insureds, in privity with the mortgage insurer or otherwise beneficiaries of the mortgage insurance policy. *Pineda*, 843 S.W.2d at 665. The court concluded that the Pinedas were neither insureds under the policy, nor in contractual privity with the insurance company. The court rejected their argument that they were beneficiaries under the PMI policy of insurance to the lender. In reaching that decision, the court followed *Hunt* v. *Jefferson Sav. & Loan Ass'n*, 756 S.W.2d 762, 765 (Tex. App.—Dallas 1988, writ denied) and

Shields v. *Atlantic Fin. Mortgage Corp.* 799 S.W.2d 441, 444 (Tex. App.—El Paso 1990, no writ), which cases held that mortgage insurance was for the benefit of the lender and not the borrower. The court also considered the statute which regulated private mortgage insurers in Texas, TEX. INS. CODE ANN. art. 21.50 (Vernon Supp. 1992), which only authorized mortgage insurance companies to insure lenders, not borrowers.

The uncontroverted affidavit of Robert P. Sonzogni, submitted by Verex in support of its motion for summary judgment, reflected that the payment made to City Federal by Verex was based upon a claim presented by City Federal pursuant to its policy of insurance and was not made on behalf of the borrower to extinguish the deficiency. Sonzogni Aff. at 6. Plaintiff's characterization of Verex's payment as one made on her behalf or for her deficiency obligations to the lender ignores the summary judgment proof, commercial reality of the relationship between Verex and its insured lender, and the nature of private mortgage insurance as held in Texas cases on the subject. *See Pineda*, 843 S.W.2d. at 664. Furthermore, any assertion that the borrower is the beneficiary of the mortgage insurance ignores the principle that insurance provides coverage for a risk of loss over which the insured has no control. If borrowers were to be considered insureds or beneficiaries under a mortgage guaranty insurance policy, they could control recovery merely by withholding payment under their mortgage note.

Based on the foregoing reasons, this Court finds that Plaintiff was not a third party beneficiary of the mortgage insurance contract between Defendant and the lender.

2. Plaintiff's "Reliance" Theory

The court has already addressed the issue of Plaintiff's "reliance" in the scheduling conference held on November 13, 1992. In ruling on the Defendant's motion for summary judgement, the court stated:

> [P]laintiff has produced no evidence that she ever had any contact with Verex before signing the note and the Deed of Trust. Moreover in her deposition the plaintiff does not even assert that she was misled by Verex, instead she thought that the person who misled her was either a representative of City Federal or the title company. Verex states in its motion that it had no contact with the plaintiff before the loan closing. Under these facts I conclude that Verex could not have misrepresented to plaintiff that the mortgage premium payments were for her benefit.

Transcript of Scheduling Conference at 6. Plaintiff has not come forward with any additional evidence of "reliance" on any words or deeds of Defendant Verex. Accordingly, this Court finds that Defendant could not have misrepresented to Plaintiff that the deficiency amount would be reduced by any insurance proceeds paid by Defendant to the lender.

3. Plaintiff's "Credit" Theory

Plaintiff additionally claims she should be "credited" the amount of insurance proceeds received by City Federal to reduce her loan deficiency. Similarly, in *Hunt* v. *Jefferson Savings and Loan-Ass'n*, 756 S.W.2d 762, 765 (Tex. App.—Dallas 1988, writ denied), *cert. denied*, 489 U.S. 1079 (1989), Hunt claimed that a fact question existed as to whether he was entitled to a credit against the deficiency for the amount of monies Jefferson Savings (the lender) received from the private mortgage insurance policy which was designed to pay in the event of default on the notes. Hunt contended that he should be entitled to a credit for twenty to twenty-five percent of the amount of the note because Jefferson required Hunt to pay the premiums. The court stated:

> No contract existed giving Hunt a right to an offset for private mortgage insurance coverage, nor is there a requirement at law for an offset. Hunt's position is

> outside the contractual agreements between the parties and wholly unsupported by the law.

Hunt, 756 S.W.2d at 765. Likewise, in the present case, no contractual obligation gave Plaintiff Palma a right to an offset for the private mortgage insurance coverage provided by Defendant Verex, and there was no legal requirement for an offset. Therefore, the Court finds that Plaintiff's credit theory must fail as a matter of law.

In conclusion, the Court finds that Plaintiff's theories of recovery for breach of contract are without merit. Accordingly, the Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant.

D. Civil Conspiracy

According to Plaintiff, the terms of the mortgage insurance contract specifically prohibited the insurer from suing the borrower to collect for amounts paid to the insured on the policy. Defendant, allegedly attempting to circumvent the terms of the insurance policy, executed an agreement with City Federal which "illegally conspired" to give Defendant the same or similar economic rights by assignment that it was prohibited from receiving by subrogation. Plaintiff asserts that the agreement between Defendant and City Federal constituted a conspiracy to do financial harm to Plaintiff.

The Texas Supreme Court has defined an actionable civil conspiracy as "a combination by two or more persons to accomplish an unlawful purpose or to accomplish a lawful purpose by an unlawful means." *Massey* v. *Armco Steel Co.*, 652 S.W.2d 932 (Tex. 1983) (citations omitted). The essential elements of a civil conspiracy are:

(1) two or more persons;

(2) an object to be accomplished;

(3) a meeting of minds on the object or course of action;

(4) one or more unlawful, overt acts; and

(5) damages as the proximate result.

Id. at 934.

Plaintiff's civil conspiracy charge is based on her contention that the assignment was illegal and that she vas entitled to a credit for the mortgage insurance proceeds. As discussed previously, the assignment was not illegal; thus, Plaintiff cannot establish one of the essential elements of a cause of action for conspiracy.

Further, Plaintiff was not a party to the mortgage insurance contract between the lender and Defendant Verex. "The general rule is that only the parties to a contract have the right to complain of a breach thereof; and if they are satisfied with the disposition which has been made of it and of all Claims under it, a third person has no right to insist that it has been broken." *Merrimack Mut. Fire Ins. Co.* v. *Allied Fairbanks Bank,* 678 S.W.2d 574, 577 (Tex. App.—Dallas 1984, writ ref'd n.r.e.). Therefore, Plaintiff has no right to complain that the terms of the mortgage insurance contract between lender and Verex were breached.

Plaintiff's claim also must fail because Plaintiff cannot establish the fourth essential element of a civil conspiracy, which requires proof of an unlawful, overt act.

Consequently, this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant on Plaintiff's conspiracy claim arising from the assignment agreement.

E. Insurance Benefits

Plaintiff claims that, independent of any rights as third party beneficiary, she is entitled to receive the proper credits for payments received by City Federal. According to Plaintiff, if City Federal had property applied the amounts received from Defendant as a result of the insurance claim and payment, the amount of the loan deficiency would have decreased. The deficiency rights "assigned" to Defendant should be credited with the insurance proceeds. Plaintiff

maintains that she was damaged by Defendant's demands for the incorrect amount owed by Plaintiff to City Federal.

This claim was the solo basis for Plaintiff's First Motion for Partial Summary Judgment (Docket Entry #49). Plaintiff's brief in support of her motion (Docket Entry #58) provided the court with no case law supporting her position. Plaintiff relied on various paragraphs cited from the deed of trust to support her position that a contract existed which she claimed required that the amount of deficiency be offset by the amount of insurance proceeds. Of the paragraphs cited by Plaintiff, the following paragraph could most likely lend itself to Plaintiff's interpretation:

> 3. Application of Payments. ... all payment received by lender under the Note . . . shall be applied by Lender first in payment of amounts payable to Lender by Borrower (for taxes and insurance), then to interest payable on the Note, then to the principal of the Note...."

However, this paragraph clearly refers to payments *received under the note*, not payments received pursuant to the mortgage insurance policy. Thus, no contract existed giving Plaintiff a right to an offset for private mortgage insurance, nor was there a requirement at law for an offset. See *Hunt* v. *Jefferson Savings and Loan Assoc.*, 756 S.W.2d 762, 765 (Tex. App.—Dallas 1989, writ denied), *cert. denied*, 489 U.S. 1079 (1939). Plaintiff failed to present sufficient evidence to support her position.

Therefore, the Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant and that Plaintiff's First Motion for Partial Summary Judgment (Docket Entry #49) be DENIED.

F. Violation of Debt Collection Statutes

Plaintiff alleges that Defendant has violated one or more of the provisions of the federal and state statutes governing fair debt collection practices.

To prevail upon a claim under either the Federal Fair Debt Collection Act or the Texas Debt Collection Act, the claimant must prove that the defendant was a debt collector, *Catherman* v. *First State Bank of Smithville*, 796 S.W.2d 299, 302 (Tex. App.—Austin 1990, no writ).

1. The Texas Act

In *Pineda* v. *PMI Mortgage Ins. Co.*, 843 S.W.2d. 660, 674 (Tex. App.—Corpus Christi 1992, writ denied), the court found that PMI, a mortgage insurer who brought a deficiency claim against the borrowers, was not within the definition of a "debt collector" as defined in TEX. REV. CIV. STAT. ANN. art. 5069-11.01 (Vernon 1987). Article 5069-11.01(c) defines "debt collector" as "any person engaging directly or indirectly in debt collection, as defined herein ...." *Id.* "Debt collection" under article 5069-1101(b) means "any action, conduct, or practice in soliciting debts for collection or in collecting debts owed or due, or alleged to be owed or due a creditor by a consumer." *Id.*

Notwithstanding the *Pineda* decision, there is testimony in the instant case which establishes that Verex is no longer issuing any policies of insurance but is, pursuant to assignments from its insureds, in the process of collecting loan deficiencies. *See, e.g.*, Partial Transcript of Class Certification Hearing, Testimony of Thomas E. Anderson at 41 & 49 (Docket Entry 173). This case is thereby distinguishable from the-facts in the *Pineda* case, and this Court finds that a material issue of fact exists as to Defendant Verex's status as a "debt collector."

Defendants further rely on *Pineda* v. *PMI Mortgage Ins. Co.*, 843 S.W.2d 660, 674 (Tex. App.—Corpus Christi 1992,

writ denied) for its finding that the activities of PMI were not within the definition of "debt collection," as it relates to the debts as being due to a "creditor."

Section (f) of art. 5069-11.01 defines a "creditor" as a "party to a consumer transaction other than a consumer." TEX. REV. CIV. STAT. ANN. art. 5069-11.01(f) (Vernon 1987). The *Pineda* court, without discussing the definition of "consumer transaction," concluded that because the Pinedas were neither insureds nor beneficiaries of the PMI insurance policy issued to the lender, any "consumer transaction" had to have taken place between the lender and the Pinedas. The court elaborated that the Subrogation and Assignment Agreement between the lender and PMI and the endorsement and negotiation of the Pineda note to PMI all occurred after an "consumer transaction" that the Pinedas may have had with the lender.

This Court believes that the *Pineda* court's reasoning is faulty. The *Pineda* court failed to look to the definition of "consumer transaction," which by statute is any "transaction in which one or more of the parties is a consumer." TEX. REV. CIV. STAT. ANN. art. 5069-11.01(e) (Vernon 1987). A "consumer" under this article is "an individual who owes or allegedly owes a debt created primarily for personal, family, or household purposes." *Id.* at (d). While it is true that the plaintiffs in both *Pineda* and the instant cast were not a party to any "consumer transaction" with the defendants, it is clear that the Plaintiffs entered into a consumer transaction with the mortgage lenders, and that the defendants' policies were purchased as a requirement of such transaction. The Defendant, through assignment, stands in the shoes of the mortgage lender to recover the deficiency due on the note. Consequently, this Court concludes that Defendant cannot claim that it was not a part of the "consumer transaction" in which its services were purchased. Verex is currently collecting the debt owed to city Federal through its

assignment agreement with City Federal, and thus is covered by the statute.

For the foregoing reasons, this Court RECOMMENDS that summary judgment be DENIED as to Plaintiff's claims under the Texas Debt Collection Act.

2. The Federal Act

The legislative history of the Federal Fair Debt Collection Practices Act "indicates conclusively that a debt collector does not include [a] consumer's creditors, a mortgage servicing company, or an assignee of a debt, as long as the debt was not in default at the time it was assigned." *Perry* v. *Stewart Title Co.*, 756 F.2d 1197, 1208 (5th Cir. 1985) (citations omitted), *rehearing denied in relevant part*, 761 F.2d 237 (5th Cir. 1985). In the present case, the debt was already in default at the time it was assigned. Therefore, it appears that Defendant qualifies at a "debt collector" under the federal act. Consequently, this Court RECOMMENDS that Defendant's motion for summary judgment on the Federal Fair Debt Collection Act be DENIED.

G. Deceptive Trade Practices

Plaintiff alleges that she is a consumer of services under the Deceptive Trade Practices Act, and that Defendants engaged in an "unconscionable action or course of action" in initiating collection activities against Plaintiff as those terms are used in the statute. *See* TEX BUS. & COM CODE ANN. § 17.45(5) (Vernon 1987). Plaintiff alleges that Defendant committed the following deceptive acts:

(a) Defendant failed to disclose information concerning goods or services (that Plaintiff would not be entitled to any benefits of the insurance contract) which was known at the time Plaintiff entered into the promissory note; and

(b) Defendant allowed Plaintiff to pay good and valuable consideration for goods or services which were not to be provided.

Plaintiff further asserts that there was no way for her to know the terms and provisions of the private mortgage insurance policy insuring her loan. Because she had never been shown the policy, the commitment, or the certificate of insurance, or received any printed material regarding the terms and provisions of the policy, Plaintiff claims that by using a "contrived assignment" of a "bogus deficiency" created through a violation of its own policy, Verex allegedly intended to to use Plaintiff's lack of knowledge and experience to obtain a judgment on its claim. Plaintiff alleges that Verex knew or should have known that the implementation of its scheme was in violation of its own policy terms and the laws of the State of Texas.

Defendants have moved for summary judgment on the ground that Plaintiff is not a "consumer" and therefore lacks standing to sue under the Deceptive Trade Practices Act (DTPA). It is well-established that only a consumer has standing to maintain a private cause of action for treble damages and attorney's fees under section 17.50(a) of the DTPA. *Flenniken* v. *Longview Bank and Trust Co.*, 661 S.W.2d 705, 706 (Tex. 1984) (citations omitted).

The DTPA defines a consumer as one who "seeks or acquires by purchase or lease, any goods or services." TEX BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987). Under the DTPA, goods include real property, and services include services furnished in connection with the sale of goods. *Flenniken*, 661 S.W.2d at 706.

The facts in *Flenniken* are helpful in determining Plaintiff's status in the instant case.

The Flennikens paid cash and executed a mechanic's lien note in exchange for the contractor's promise to construct a house on their property. The note was further secured by a

deed of trust to the Flennikens' property. The contractor then assigned the Flennikens' note and his contract lien to the Bank in exchange for interim construction financing. The contractor abandoned the project after completing only twenty percent of the work. The Bank foreclosed on the property under the terms of the deed of trust.

The Bank argued that the Flennikens were not "consumers" under the DTPA. The Supreme Court of Texas disagreed. The court noted that the Flennikens were consumers to the extent they sought to acquire a house from the contractor, as well as his services. *Flenniken*, 661 S.W.2d at 706. The court then found that the contractor's assignment of the Flennikens' note to the Bank was not a separate transaction, stating that "[p]rivity between a plaintiff and a defendant is not a consideration in deciding the plaintiff's status as a consumer under the DTPA." *Id.* at 706-707. "A plaintiff establishes his standing as a consumer in terms of his relationship to a transaction, not by a contractual relationship with the defendant." *Id.* at 707. "From the Flennikens' perspective, there was only one transaction: the purchase of a house." *Id.* The court found that the contractor's financing arrangement with the Bank was merely his means of making a sale, and that the Bank's unconscionable act in causing the foreclosure of the Flennikens' property arose out of the Flennikens' transaction with the contractor. Therefore, the court hold that the Flenniken were consumers as to all parties who sought to enjoy the benefits of that transaction including the Bank. *Id.*

In the instant case, Plaintiff sought to acquire a condominium. As a part of that transaction, she obtained a loan from City Federal. As a condition of the loan, Plaintiff was required to purchase mortgage insurance. From Plaintiff's perspective, as in the *Flenniken* case, there was only one transaction: the purchase of a condominium. As in *Flenniken*, Plaintiff established her standing as a consumer in terms of her relationship to the transaction, not by a

contractual relationship with the defendant. *Flenniken*, 661 S.W.2d at 707. Plaintiff, therefore, is a consumer as to all parties who sought to enjoy the benefits of that transaction, including Verex.

This Court therefore RECOMMENDS that defendant's motion for summary judgment be DENIED as to Plaintiff's DTPA claim.

H. Unjust Enrichment

Plaintiff alleges that Defendant would be unjustly enriched if allowed to recover twice for the same insurance transaction.

As discussed above, in *Pineda* the court of appeals upheld an assignment which was much the same as the one in the present case. In consideration of PMI's payment of the lender's claim, the lender assigned its rights under the loan documents to pursue claims for the deficiency against the Pinedas. Although the lender's claim was paid by PMI, the lender did not credit the payment to the outstanding loan deficiency at the time of its assignment of the note. The court found that PMI the present note holder, did not seek to recover the same deficiency twice, and uphold the assignment. *Id.* at 665.

Because the facts in the instant case are so closely analogous to the pertinent facts in the *Pineda* case, Plaintiff's "unjust enrichment" or "double recovery" theory is simply not supported by Texas case law. Accordingly, this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant on Plaintiff's 'unjust enrichment claim.

I. Fraud and Extortion

According to Plaintiff, Verex willfully and maliciously set to:

a) violate the provisions of the private mortgage insurance policy issued by Verex;

b) assort fraudulent claims; and

c) threaten to file or file lawsuits against the Plaintiff and other purchasers in order to force Plaintiff and other purchasers to pay claims they did not owe.

Plaintiff alleges that Verex made fraudulent assertions in writing and made threats of litigation which were transmitted to the purchasers via the U.S. Mail in its scheme to extort money from purchasers.

1. Fraud

The elements of an actionable fraud in Texas are as follows: (1) that a material representation was made; (2) that the representation was false; (3) that when the speaker made the representation, he know it was false, or made it recklessly without any knowledge of its truth and as a positive assertion; (4) that he made the representation with the intention that t should be acted upon by the party; (5) that the party acted in reliance upon the representation and (6) that the party thereby suffered injury. *Trenholm* v. *Ratcliff*, 646 S.W.2d 927, (Tex. 1983).

Plaintiff's fraud claim must fail because there is no genuine issue of material fact as to one or more of the essential elements of fraud. The Court has already concluded that Verex could not have misrepresented to plaintiff that the mortgage premium payments were for her benefit, and granted Verex's motion for Summary Judgment on that claim. Exhibit 4 to Plaintiff's Supplement to Motion for summary Judgment and Motions for Partial Summary Judgment at 6. Because there was no false representation as required by the first two elements of fraud, Defendants are entitled to summary judgment as a matter of law. Therefore, this Court RECOMMENDS that summary judgment be granted in favor of Verex on Plaintiff's fraud claim.

2. Extortion

As previously discussed, Plaintiff had no right to complain that Defendant Verex violated the provisions of the private mortgage insurance policy issued by Verex to the lender, City Federal. Defendant Verex has the right, as assignee, to pursue its claim for the deficiency, and "it is the established rule that it is not duress to institute or threaten to institute civil suits,...or for any person to declare that he intends to use the courts wherein to insist upon what he believes to be his legal rights, at least where the threatened action is made in good faith, that is, in the honest belief that a good cause of action exists, and does not involve some actual or threatened abuse of process." *Southmark Properties* v. *Charles House Corp.* 742 F.2d 862, 876 (5th Cir. 1984). Although duress may be found where a threat of civil action or use of an available remedy is made only for the purposes of extortion, Plaintiff has not come forward with competent summary judgment proof that Defendant pursued the deficiency claim merely to extort money from Plaintiff.

Therefore, this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendant on Plaintiff's extortion claim.

J. Violations of the Insurance Code

Plaintiff asserts that § 21.21(16) incorporates the "laundry list" of items prescribed by § 17.46 of the Texas Business and Commerce Code. Plaintiff asserts that subsections (5) and (12) of § 17.46 apply to the instant case, as Verex represented that the policy conferred or involved rights, revenues, or obligations which it did not have or which were prohibited by law in that they were not approved by the State Board of Insurance.

Plaintiff further asserts that Defendant's assignment agreement violated article 21.21A of the Insurance Code. Plaintiff's claims under these two insurance code sections will be discussed separately below.

1. Violation of Article 21.21A §1

Plaintiff asserts that Defendant's assignment agreement violated article 21.21A § 1 of the Texas Insurance Code, which provides, in part:

> No insurer or agent thereof may make any contract of insurance or agreement as to such contract other than as expressed in the policy issued thereon....

TEX. INS. CODE ANN. art. 21.21A § 1 (Vernon 1981). However, any alleged policy prohibition against assignment of an interest under the policy is inapplicable to the assignment of causes of action which come into existence after the loss has occurred. *McLaren* v. *Imperial Casualty and Indemnity Co.*, 767 F. Supp. 1364, 1377 (N.D. Tex. 1991), *aff'd in relevant part*, 968 F.2d. 17 (5th Cir. 1992), *cert. denied*, 113 S.Ct. 1269 (1993). In the instant case, the loss occurred upon foreclosure, and the deficiency cause of action then came into existence. The assignment of the deficiency cause of action was not part of the contract of insurance, but a settlement contract—it was not a modification of the agreement before the loss, it was an assignment and settlement of a claim. Therefore, any term contained in the mortgage insurance policy could not prohibit the subsequent assignment of the deficiency cause of action after a loss occurred.

Based on the foregoing, this Court RECOMMENDS that summary judgment be GRANTED in favor of Defendants on Plaintiff's causes of action under the Texas Insurance Code.

2. Violation of Article 21.21 § 16

Section 21-21 § 16(a) provides, in part:

> Any person who has sustained actual damages as a result of another's engaging in an act or practice declared...under this Article to be ... unfair or deceptive acts or practices in the business of

> *insurance...may maintain an action against* the person or persons engaging in such acts or practices.

Tex. Ins. Code Ann. art 21.21 §16(a) (Vernon Supp. 1994). Despite this broad statutory language which seems to give standing to "any person," Plaintiff does not have standing to bring an action under Article 21 of the Texas Insurance Code.

The Fifth Circuit Court of Appeals recently reiterated the test for standing In *Warfield* v. *Fidelity and Deposit Co.*, 904 F.2d 322, 327 (5th Cir. 1990) (relying on *Chaffin* v. *Transamerica Ins. Co.*, 731 S.W.2d 728, 731 (Tex. App.—Houston [14th Dist.] 1987, writ ref'd n.r.e.) and *Hermann Hospital* v. *National Standard Ins.*, 776 S.W.2d 249, 252 (Tex. App.—Houston [1st Dist.] 1989, writ denied). The court stated that, "absent privity of contract or some sort of reliance by the person bringing a claim on the words or deeds of the insurer, a suit will not lie under art. 21.21."

This Court has already determined that Plaintiff was not in privity of contract with Defendant, nor was Plaintiff a third party beneficiary of the contract between Defendant and the lender, City Federal. The uncontroverted summary judgment proof also established that Plaintiff had absolutely no contact with Defendant about the payment of premiums before she paid the premiums, and that the first contact that she had with any Verex representative with respect to the collection of the deficiency was her receipt of the demand letter.

Based on these admissions, this Court determines that Plaintiff does not meet the standing requirement of Article 21.21 § 16 under *Warfield*. Accordingly, this Court RECOMMENDS that summary Judgment be GRANTED in favor of Defendants on this claim.

N. Estoppel, Waiver, and Usury

Neither Plaintiff nor Defendant has adequately briefed these Issues in order for the court to make an educated determination whether either party is entitled to judgment as

a matter of law. Neither side specified the facts relied upon in support of, or in opposition to, these defenses. As a result, the Court must RECOMMEND that summary judgment be DENIED, as neither party has succeeded in proving that they are entitled to judgment as a matter law.

III. PLAINTIFF'S MOTION FOR CERTIFICATION OF CLASS

Pursuant to the Court's Order Reconsidering Recommendation of class Certification (Docket Entry #92), the Court has examined Plaintiff's standing as a third party beneficiary to the insurance contract, and found that Plaintiff does not have standing to pursue a breach of contract claim, or any other claim, based upon her alleged status as a third party beneficiary. Accordingly, the Court RECOMMENDS that Plaintiff's Motion for Certification of Class be DENIED as to any of Plaintiff's claims which are based upon her assertion of third party beneficiary status. Likewise, the Court RECOMMENDS that Plaintiff's Motion for Certification of class be DENIED as to any claims upon which this Court has RECOMMENDED that summary judgment be GRANTED.

With regard to the issues which have survived summary judgment scrutiny, or which were not addressed in the motion for summary judgment, the court finds it appropriate to allow Plaintiff a chance to re-urge a certification of class on these issues. These Issues include those claims under the Texas and Federal fair debt collection statutes, the Texas Deceptive Trade Practices Act, and the defenses of estoppel, waiver, and usury. Because the Court finds that many of these issues were not fully addressed in the prior hearing, another hearing is necessary to decide whether class certification is appropriate.

IV. CONCLUSION

For the reasons discussed above, it is hereby RECOMMENDED that Plaintiff's Motion for Partial

Summary Judgment (Docket Entry #49) be DENIED; Plaintiff's Motion for Sanctions (Docket Entry #59) be DENIED; Plaintiff's Motion for Partial Summary Judgment (Docket Entry #68) be DENIED; and Defendant's Request for Oral Submission (Docket Entry #82) be DENIED. It is further RECOMMENDED that Defendant's Motion for Partial Summary Judgment as to Plaintiff's First Amended Complaint and First Supplemental Complaint (Docket Entry #54) be GRANTED in favor of Verex as to the following claims: illegal assignment/lack of standing, breach of contract, civil conspiracy, insurance benefits, unjust enrichment, fraud, extortion, and insurance code. it Is RECOMMENDED that Defendant's Motion for Partial Summary Judgment as to Plaintiff's First Amended Complaint and First Supplemental Complaint (Docket Entry #54) be DENIED with respect to Plaintiff's claims under the Texas and Federal fair debt collection statutes and the Texas Deceptive Trade Practices Act, and with respect to Plaintiff's defenses of estoppel, waiver, and usury. Claims related to Verex's counterclaim and Plaintiff's asserted affirmative defenses against the deficiency recovery which were not based upon the mortgage insurance policy, i.e., claims related to the foreclosure procedures, were not the subject of Defendant's motion and thus were not addressed by the Court.

> The Clerk shall send copies of this Memorandum and Recommendation to the respective parties who have ten (10) days from the receipt thereof to file written objections thereto pursuant to General Order 80-5. Failure to file written objections within the time period mentioned shall bar an aggrieved party from attacking the factual finding on appeal.

The original of any written objection shall be filed with the United States District Clerk, P.O. Box 61010, Houston, Texas 77208; copies of such objections shall be mailed to opposing parties and to the chambers of the undersigned, P.O. Box 61167, Houston, Texas 77208.

SIGNED at Houston, Texas this 2nd of March, 1994.

/s/ Nancy Pecht

NANCY K. PECHT
UNITED STATES MAGISTRATE JUDGE

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-91-2390

[Entered: May 18, 1993]

NANCY ABSHIRE PALMA, PLAINTIFF,

v.

VEREX ASSURANCE, INC., DEFENDANT

ORDER

Pursuant to 28 U.S.C. § 636(b)(1) and the Cost and Delay Reduction Plan under the Civil Justice Reform Act, this case is referred to United States Magistrate Judge Nancy R. Pecht.

SIGNED on this 17th day of May, 1993.

/s/ Sim Lake
SIM LAKE
UNITED STATES DISTRICT JUDGE

APPENDIX I

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 95-20034

[Filed: July 17, 1996]

NANCY A. PALMA, PLAINTIFF - APPELLANT

v.

VEREX ASSURANCE INC, DEFENDANT - APPELLEE

Appeal from the United States District Court for the Southern District of Texas, Houston

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ON PETITIONS FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Opinion _____, 5 Cir., _____, _____ F.3d _____)

Before DAVIS, PARKER, Circuit Judges, and BUNTON[1], District Judge.

PER CURIAM:

(✓) The Petitions for Rehearing are DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FRAP and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) The Petitions for Rehearing are DENIED and the court having been polled at the request of one of the members of

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[1] District Judge of the Western District of Texas, sitting by designation.

the court and a majority of the judges who are in regular active service not having voted in favor, (FRAP and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

( ) A member of this court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Robert M. Parker
ROBERT M. PARKER
UNITED STATES CIRCUIT JUDGE

APPENDIX J

COURT OF APPEALS OF TEXAS, TYLER.

No. 12-93-00290-CV.

[Opinion delivered: August 29, 1996]

FIRST AMERICAN TITLE INSURANCE CO. OF TEXAS & HENDERSON SAVINGS & LOAN ASSOCIATION, APPELLANTS,

v.

KENNY WILLARD, JIMMIE KATHERINE COLLEY WILLARD, & LONE STAR GAS COMPANY, APPELLEES.

Appeal From The Fourth Judicial District Court Of Rusk County, Texas

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Before RAMEY, C.J., and HOLCOMB and HADDEN, JJ.

RAMEY, Chief Justice.

This is a pipeline easement encroachment case. After a jury trial, First American Title Insurance Company of Texas ("First American"), a title insurance underwriter, and Henderson Savings & Loan Association ("Henderson"), a lender, appeal from a money judgment in favor of Lone Star Gas Company, a Division of Enserch Corp. ("Lone Star"), the pipeline owner, and Kenny Willard ("Willard"), a home builder/borrower[1]. First American assigns 27 points of error and Henderson assigns two additional points; Lone Star urges

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[1] Jimmie Katherine Colley Willard had joined her husband as a cross-plaintiff; she, however, made no recovery and is not a party to this appeal.

two cross-points of error. We will affirm in part and reverse and render in part.

In October 1987, a house was being built for Willard when it was discovered that the structure was located above Lone Star's gas pipeline. The transaction had arisen when Willard sought interim and permanent financing from Henderson to build a house on a 2.59 acre tract conveyed to him by his parents.

A Builders and Mechanics Lien contract was executed by Willard and his wife to the construction contractor, South Place Building Contractors, Inc. ("South Place"), in the principal amount of $43,900, which was assigned to Henderson. The lender, Henderson, required a policy of mortgagee's title insurance to protect its loan collateral in the event a title defect reduced the property's value. Henderson secured a title insurance binder effective during house construction and a commitment to issue the mortgagee's title policy from Pearson Abstract & Title Company ("Pearson"), First American's agent.

Willard testified that he selected the location for the house. One of the factors considered was an unrelated but visibly marked Texas Utilities' pipeline right-of-way across another portion of Willard's tract. As to the Lone Star pipeline, the company had obtained a blanket easement[2] across Willard's land from Willard's grandparents in 1963 which easement was recorded. Neither Willard nor the construction contractor, Jim Peterson ("Peterson"), of South Place, nor any of the people involved in the house construction were aware of the blanket easement or the pipeline.

Earl Young, Pearson's owner, who was deceased at the time of trial and whose testimony had not been preserved for

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[2] An easement without a metes and bounds description of its location on the property.

the trial, prepared the mortgagee title insurance binder and title policy commitment. The binder certified that the Willards had "a good and indefeasible title to the land ..." upon which the house was being constructed, the exceptions being Henderson's lien and "[a]ny easement and/or right-of-way which is visible and apparent from an examination of the premises." From the circumstances, it was the view of the testifying expert witnesses that the oversight in not excepting the Lone Star easement from title policy coverage was a "search error" by Young.

At some disputed point in the course of the construction project, after the Willard house was more than 50% completed, a Lone Star pipeline employee observed that the house was situated over the company's pipeline. Upon being informed thereafter of the existence of the pipeline under the house, Henderson stopped financing the project. The parties agreed that the house construction was then too advanced to relocate the house; they, however, did favor moving the pipeline from beneath the house. First American acknowledged its prior commitment to write the title insurance, which included coverage for Lone Star's easement. Henderson resumed its financing commitment to Willard after Willard executed a hold harmless agreement to Henderson indemnifying Henderson (and the contractor) from any claims resulting from the location of the house above the pipeline. Thereafter, the house was completed and the interim financing was closed into permanent financing; First American's title policy was issued without an exception to its coverage of Lone Star's easement. The premium for the mortgagee title insurance policy was charged to Willard as a part of the loan settlement expense and paid from the proceeds of Willard's loan.[3]

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[3] Under the rules of the State Board of Insurance, now the Texas Department of Insurance, the underwriter, First American, received 20% of the premium or approximately $78 for writing this title

Since the closing, Willard has regularly made his loan payments to Henderson; the pipeline has not been moved from beneath Willard's house. Lone Star determined that the cost of such a move would be $16,000.[4] When the case was tried in April 1993, First American conceded that under its title policy with Henderson it was responsible for the cost of removing the pipeline. First American offered $18,000 to pay for the relocation of the pipeline; the offer had been refused by Lone Star because of additional expenses it had incurred due to the encroachment and also because the offer had not been made in writing.

The Jury Verdict

The jury questions were answered favorably to Lone Star and Willard as follows:

1. The trespass of the Willards, Henderson and First American caused damage to Lone Star's pipeline.

2. Henderson acted with malice in committing the trespass.

3. First American acted with malice in committing the trespass.

4. First American engaged in unfair or deceptive act(s) or practice(s) with respect to Lone Star.

5. First American knowingly engaged in these act(s).

6. Lone Star suffered damages in the amount of $16,000 for the repairs and loss of use of its pipeline from the trespass.

7. $50,000 is assessed against Henderson and awarded to Lone Star as exemplary damages.

8. $25,000 is assessed against First American and awarded to Lone Star as exemplary damages.

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insurance coverage.

[4] In the latter part of 1988, Lone Star had estimated the pipeline moving expense to be $12,000.

9. $50,000 is assessed against First American and awarded to Lone Star as additional damages.

10. $45,000 is assessed as the reasonable attorney's fees to be awarded to Lone Star.

11. First American engaged in unfair or deceptive act(s) or practice(s) with respect to Willard.

12. First American knowingly engaged in unfair or deceptive act(s) or practices(s) with respect to Willard.

13. Willard suffered damages in the amount of $150,000 for mental anguish and the decrease in the market value of his property resulting from the actions of First American.

14. $43,000 is assessed against First American and awarded to Willard as additional damages.

15. First American engaged in false, misleading or deceptive act(s) or practice(s) which were a producing cause of damages to Willard.

16. First American knowingly engaged in the false, misleading or deceptive conduct.

17. $100,000 is assessed against First American and awarded to Willard for the difference in market value of his property as constructed and as represented, consequential damages and his mental anguish.

18. $50,000 is assessed against First American and awarded to Willard as additional damages because of its knowingly engaging in false, misleading or deceptive conduct which was a producing cause of damages to Willard.

19. $5,000 is assessed as Willard's attorney's fees for preparation and trial, $5,000 for an appeal to the Court of Appeals and $500 for responding to an Application for Writ of Error in the Supreme Court and $500 if the Application is granted.

First American and Henderson each filed Motions for Judgment Non Obstante Veredicto and motions for new trial.

The trial court overruled the motions except that it disregarded the jury's finding that Henderson acted with malice in aiding and assisting the trespass. Because it considered the damages duplicative, the court required Willard to elect between his recovery under the TEX. INS. CODE ANN. art. 21.21 § 16(b) (Vernon Supp. 1991) and the Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA") cause of action, TEX. BUS. & COM. CODE ANN. § 17.41, et seq. (Vernon 1977) (amended 1979); Willard elected to recover damages under the Insurance Code claim. The court, therefore, disregarded the DTPA damage findings numbered 17 and 18. Additionally, the court rendered judgment that Lone Star's easement was valid.

THE TRIAL COURT JUDGMENT

The court rendered judgment that Lone Star recover the following:

. $16,000 in actual damages for trespass from Willard, Henderson, First American and South Place;

. $45,000 attorney's fees;

. $25,000 exemplary damages from First American for trespass;

. $50,000 additional damages from First American;

. 10% pre-judgment interest commencing August 8, 1989 from Willard, Henderson, First American and South Place; and

. 10% interest on the Judgment.

The court rendered judgment that Willard recover the following:

. $150,000 actual damages for Insurance Code violations from First American;

. $300,000 (an additional sum of two times the actual damages) for deceptive practices under sec. 16(b)(1) of art. 21.21 of the Insurance Code;

. Attorney's fees;

. 10% pre-judgment interest commencing August 8, 1989 from First American; and

. 10% interest on the Judgment. Liability under Art. 21.21 of the Insurance Code.

First American's first thirteen points assert that for a variety of reasons neither Willard nor Lone Star should recover damages for unfair claim settlement practices against the title insurer. These points are couched in evidence sufficiency points, assignment of lack of standing to bring the claims, and, as applicable to Willard, the lack of duty by First American to discover or disclose to Willard the existence of the Lone Star easement/pipeline across his property.

When, as here, the appellant does not have the burden of proof at trial, a legal sufficiency point of error allows the court to examine only the evidence and inferences that tend to support the jury's findings while ignoring all evidence to the contrary. *Weirich* v. *Weirich*, 833 S.W.2d 942, 945 (Tex. 1992); *Havner* v. *E-Z Mart Stores, Inc.*, 825 S.W.2d 456, 459 (Tex. 1992). If there is any probative evidence to support the jury's findings, the "no evidence" challenge must be overruled. *In re King's Estate*, 150 Tex. 662, 664, 244 S.W.2d 660, 661 (1951). On a factual insufficiency challenge, having considered all of the evidence for and against the jury's finding, the court of appeals must affirm the judgment based upon the verdict unless it is so contrary to the overwhelming weight of the evidence as to be clearly wrong and manifestly unjust. *Ibid*; *Dyson* v. *Olin Corp.*, 692 S.W.2d 456, 457 (Tex. 1985).

The prevailing parties strongly urge that First American had waived these points of error because the trial court error was invited by First American. Specifically, Lone Star and Willard insist that First American had conceded liability by its own actions and that of its counsel including its earlier

letters to Henderson and by its attorney's opening statement to the jury and his closing argument; furthermore, First American offered the testimony of Tommy R. Goode, Henderson's President, and the testimony of expert witness, Henderson attorney Robert Minton, both of whom concluded that First American had assumed liability for the house's location across Lone Star's easement.

It is undisputed that First American did make liability concessions. In our view of the evidence, the asserted concessions pertain to First American's acknowledgement of liability to its insured, Henderson, because of First American's failure to except from coverage the Lone Star easement encroachment by Willard's house construction. There is no reference in the alleged concessions to unfair claims settlement practices or deceptive trade practices.

A review of the record shows that the two references in First American's counsel's opening statement specifically related to a concession to pay the expenses for moving the pipeline from beneath Willard's house because it had covered that risk in the policy written for Henderson. Likewise, the letter from First American to Pearson, dated September 4, 1990, specifically acknowledged that First American will be liable to indemnify Henderson for Henderson's damages arising out of the encroachment upon Lone Star's easement. The second letter, from First American to David Brown, Henderson's legal counsel, dated September 24, 1990, acknowledged that First American "has accepted policy liability for the referenced matter." (Emphasis ours).

Likewise the excerpts from expert witness Minton's testimony specifically pertained to First American's policy liability to Henderson. The same applies to Goode's testimony concerning First American's liability to his company because of the failure to except the easement in the binder and commitment.

Finally, Appellees urge that First American's counsel conceded liability in his closing argument. In the cited portion of the argument, Appellants' counsel discussed the original disagreement between First American and Henderson as to policy coverage because of a factual dispute as to liability for Lone Star's easement. First American's counsel concluded by stating that his company had recognized its liability under the policy contract and had now "done everything that they're supposed to do under the policy." (Emphasis ours).

Despite showing that the concession evidence related only to First American's policy obligation to indemnify Henderson for the easement encroachment, we have also considered Lone Star's authorities for the proposition that a party may not complain on appeal of action by the trial court that an appellant had invited or induced. See *General Chemical Corp.* v. *De La Lastra*, 852 S.W.2d 916 (Tex. 1993), *cert. dismissed*, --- U.S. ----, 114 S.Ct. 490, 126 L.Ed.2d 440 (1993); *Tracy* v. *Annie's Attic, Inc.*, 840 S.W.2d 527 (Tex. App.—Tyler 1992, writ denied); *Daniels* v. *Pecan Valley Ranch, Inc.*, 831 S.W.2d 372 (Tex. App.—San Antonio 1992, writ denied), *cert. denied*, --- U.S. ----, 113 S.Ct. 2944 (1993). In these cases the complaining party had sought specific action by the trial court, the court acquiesced and made the requested ruling, and then on appeal the complaining party assigned that invited conduct as ground for reversal.

These cases are inapposite. Here, First American or Henderson did not lure the trial court into any ruling or conduct which First American now asserts to be reversible error. First American did not invite the trial court to submit the jury questions on Insurance Code or DTPA violations; these were Appellees' jury issues. If the principle of invited error may be extended to the realm of invited jury responses, First American's concessions of liability before the jury related only to the extent of title policy coverage, not to

Appellants' other theories of recovery which First American has challenged here. We therefore agree with First American that the concessions did not invite trial court error.

As for the alleged claim of Insurance Code violations, Section 16 of art. 21.21 of the Texas Insurance Code does not confer upon third party claimants a direct cause of action against an insurer for unfair claim settlement practices. *Allstate Insurance Company* v. *Watson*, 876 S.W.2d 145, 147 (Tex. 1994). Lone Star has acknowledged this to be a correct statement of Texas law; its recovery for unfair claim settlement practices is dependent upon the validity of its contention that First American invited error, with which we have not agreed. First American's points of error five, six, eight, nine and twenty one are sustained. It will not be necessary to address First American's point seven.

Willard, however, contends that Watson is not controlling as to his recovery of damages. Willard argues that his evidence pertaining to his standing to assert the unfair settlement practices claim against First American is distinguishable from the Watson facts, first, because he had paid the premium for the insurance policy and second, because he would directly benefit from the payment by the insurer of the expense of removal of the pipeline from beneath his house.

It is undisputed that Willard paid the premium to First American for Henderson's title policy. Customarily, the home builder/borrower pays this expense, because a lending institution must require that the borrower has title to the real property on which its loan proceeds will be expended. Rather than require the borrower to incur the expense of a title examination, a title insurance policy in favor of the lender is an inexpensive means of assuring the validity of its title available to the borrower. We disagree that the borrower's act of paying the premium for the title insurance injects the borrower into the insurance contract as a party to the policy.

Furthermore, Willard's contention that he would derive a significant benefit from First American's payment of the expense of moving Lone Star's pipeline from beneath his house does not alter his relationship with the contracting parties. Certainly the insured, Henderson, would benefit from First American's indemnification of the claim against it. As in Watson, a benefit to a third party does not thrust that party into a contractual relationship between the two other parties or confer upon Willard a direct cause of action against First American for unfair claim settlement practices.

The borrower, Willard, did not purchase an owner's title policy which would have contractually provided the relief he seeks here. Should we grant such relief, Willard would enjoy the fruits of a contractual relationship he seeks with First American without buying a policy. Willard argues that there was testimony from First American that they would not have offered such an owner's title policy to Willard had he requested it. First American honored its prior commitment to Henderson to cover the unexcepted Lone Star risk but doubtless would not have offered the same coverage to Willard absent a commitment to do so before the encroachment came to light.

It is undisputed that First American is the insurer and only Henderson is the insured of the subject policy. We do not agree that Willard's posture in this transaction circumvents the supreme court's opinion in Watson. For all the reasons stated, Willard's recovery in the judgment for First American's alleged misconduct in its manner and procedure in settling with them must be disallowed. We sustain First American's third and fourth points of error. Therefore, its first, second, tenth, eleventh, twelfth and thirteenth points of error will not be addressed.

LIABILITY UNDER THE TRESPASS THEORY

In answer to the first jury question, the jury found that both First American and Henderson had trespassed, causing

damage to Lone Star's pipeline. It being undisputed that neither company physically participated in the construction of Willard's house construction over the pipeline, the liability theory asserted against them by Lone Star is predicated upon their conduct in aiding, assisting or advising Willard in his trespass upon Lone Star's easement. *McDaniel Brothers* v. *Wilson*, 70 S.W.2d 618, 621 (Tex. Civ. App.—Beaumont 1934, writ ref'd).

A title insurer is not a title abstractor, and it owes no duty to examine title either for the insured or for any third party. *Martinka* v. *Commonwealth Land Title Ins. Co.*, 836 S.W.2d 773, 777 (Tex. App.—Houston [1st Dist.] 1992, writ denied). The title information recited in the binder is procured by the insurer for its own purposes in determining the title to the property and for its use in deciding if there are title risks it should not underwrite; the binder was not prepared or furnished for Willard's use or reliance. *Ibid*; *Stewart Title Guar. Co.* v. *Cheatham*, 764 S.W.2d 315, 320 (Tex. App.—Texarkana 1988, writ denied); *Tamburine* v. *Center Sav. Assn.*, 583 S.W.2d 942, 949 (Tex. Civ. App.—Tyler 1979, writ ref'd n.r.e.). First American did not publish the binder to Willard nor did any of its agents or employees discuss title information with Willard. There was evidence that the contractor, Peterson, actually obtained the binder from Pearson and delivered it to Henderson's office but that First American had no part in the arrangements that permitted Peterson to see the document.

Lone Star asserts that First American is liable for aiding, assisting or advising the trespasser, because Pearson's president, Young, should have disclosed the existence of the Lone Star easement in the title policy binder. A title insurer may be liable under the DTPA for affirmative representations that are a producing cause of damages to the insured. *Ibid*; *First Title Co.* v. *Garrett*, 860 S.W.2d 74, 76 (Tex. 1993). As stated, however, the only affirmative representation in the interim construction binder was that the mortgagor had good

and indefeasible title to the land covered by the policy. There was no mention of the presence or absence of Lone Star's easement; this silence was not an actionable affirmative representation as to the existence or non-existence of Lone Star's easement. See *Chicago Title Insurance Company* v. *McDaniel*, 875 S.W.2d 310, 311 (Tex. 1994); *Tri-Legends Corp.* v. *Ticor Title Ins. Co. of California*, 889 S.W.2d 432, 444 (Tex. App.—Houston [14th Dist.] 1994, writ denied). Furthermore, one to whom a representation is not directed is not entitled to rely on that representation. *Spring Garden 79U, Inc.* v. *Stewart Title Co.*, 874 S.W.2d 945 (Tex. App.—Houston [1st Dist.] 1994, no writ). Lone Star also argues that First American, after learning of the pipeline, aided, abetted or advised in the perpetration of the trespass by later honoring its prior agreement to write the title insurance without excepting Lone Star's easement from its coverage. We do not agree that First American at that time could withdraw its commitment to provide this title insurance for Henderson. First American had not excepted the Lone Star easement risk from its coverage in the binder, and therefore Henderson was protected under First American's policy from Lone Star's claim.

A mortgagee title insurance policy is an indemnity policy imposing upon the insurer, First American, only the duty to indemnify the insured, Henderson, in the event of a loss occasioned by a defect in the title of its collateral. *Chicago Title Insurance Company* v. *McDaniel*, 875 S.W.2d 310, 311 (Tex. 1994). Thus, First American's liability for trespass under the policy must be predicated upon a loss sustained by Henderson. The evidence discloses that Willard had regularly made his loan payments to the time of trial and no loss had been sustained by Henderson resulting from the reduction in the value of the collateral. As discussed above, First American has conceded that it is contractually responsible for any loss to Henderson arising from the construction of the

Willard house over the Lone Star easement. We thus focus on Henderson's liability.

We first must determine whether Henderson has sustained a loss that is subject to indemnification by First American. The trial court judgment awarded $16,000 damages to Lone Star against Henderson (and the other parties it found to have trespassed over the easement). Thus, the trial court judgment obligates Henderson to pay Lone Star its actual damages from the encroachment. Furthermore, although Henderson had not prior to trial sustained an actual loss in the value of its collateral, the evidence is undisputed that the presence of an eight inch high pressure gas pipeline under the Willard house materially depreciates the market value of that property. Therefore, because of the condition of the property at trial as well as in the judgment award of the trial court, the value of Henderson's collateral has been reduced by the encroachment. For these reasons, we hold that Henderson has sustained a monetary loss from the trespass upon Lone Star's easement for which Henderson is entitled to indemnification by First American under the terms of the mortgagee title insurance policy.

We furthermore conclude that there is sufficient evidence to support the jury's affirmative finding of trespass liability as it relates to Henderson. The trespass had commenced before Henderson had knowledge of the easement; construction of the trespassing structure was in progress when Henderson was first notified of the existence of the encroachment. Upon being apprised of the pipeline's existence under the house construction, Henderson ceased financing the structure. The project stopped.

Although Henderson did not own either the property or the pipeline and did not have the incidents of ownership of either to authorize it to move either the pipeline or the house-in-progress, it appears that the trespassing condition could have been eliminated at that time. By turning off the money supply, house construction had been effectively

stopped. Uncompleted, the house was not habitable and its ultimate dismantling would have resulted under the existing financial arrangements. Likewise, the redirection of the pipeline from beneath the structure would have eliminated the trespass.

Henderson was aware that First American had failed to except the Lone Star easement from its title insurance coverage and that the policy provided for indemnification by First American for expenses incurred in terminating the trespass. Instead of exercising an option that would have resulted in eliminating the trespass, Henderson chose to secure an indemnity agreement from Willard, resume financing the house, completing the trespassing structure and continuing the trespass to the time of trial. As the entity with the financing leverage, Henderson could have arranged for the termination of the trespass. We conclude that there is sufficient evidence to support the jury finding that Henderson's determination not to require the elimination of the encroachment but rather to complete the house and continue the trespass was Henderson's intentional decision that aided and assisted Willard's trespass upon Lone Star's easement. Henderson's points of error one and two are overruled.

We hold that there is no evidence that First American is liable to Lone Star on the trespass theory because it had no relationship with or contact with Willard or Lone Star and because it had no liability to Willard due to the omission of the Lone Star easement in the binder as discussed above, and because it had no authority to control the trespassing condition by halting the financing of the house or in any other way. First American's point of error fourteen is sustained; thus, point fifteen need not be addressed. First American, however, has acknowledged that it is contractually obligated

to indemnify Henderson for the $16,000 loss sustained by Lone Star arising from the trespass.[5]

LIABILITY FOR EXEMPLARY DAMAGES

Our holding that there is no evidence that First American aided, assisted or advised Willard in the commission of the trespass forecloses recovery of exemplary damages by Lone Star against First American for such trespass. First American's sixteenth and eighteenth points of error are sustained; we need not address its seventeenth or nineteenth points.

Lone Star's Cross Point asserts that the trial court erred in granting Henderson's motion for judgment non obstante veredicto as to the jury finding that Henderson acted with malice in committing the trespass. The trial court ruled that there was no evidence to support that jury finding. Our standard of review likewise is that in order to sustain the trial court's judgment, we must consider whether there is more than a scintilla of evidence to support the jury's finding. *Mancorp, Inc.* v. *Culpepper*, 802 S.W.2d 226, 227-228 (Tex. 1990). It is undisputed that Henderson was involved in this transaction as Willard's lender for the construction of his home only. As stated, we have held that Henderson's participation as a trespasser is limited to its aiding or assisting in the trespass by not taking any action resulting in the movement of the house or the pipeline to terminate the trespassing condition. The standard for awarding exemplary damages in a trespass is:

> To authorize a finding of exemplary damages for trespass, the evidence must show some element of fraud, malice or oppression. The act which constitutes the cause of action ... must be actuated by and accompanied

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[5] The jury finding to Question 6 that Lone Star sustained $16,000 actual damages as a result of the trespass has not been challenged on appeal.

> with some evil intent, or must be the result of gross negligence or such disregard on anyone's rights as is deemed equivalent to such intent.

Houston Lighting & Power v. *Sue*, 644 S.W.2d 835, 839 (Tex. App.—Corpus Christi 1982, writ ref'd n.r.e.).

There was no evidence that Henderson was actuated by any evil intent or gross negligence in not requiring the house or the pipeline to be moved. Likewise, no evidence was adduced suggesting that Henderson's conduct suggested such disregard of any parties' rights as is deemed equivalent to such evil intent. Henderson's failure to insist upon the elimination of the trespass was simply a passive response to the problem. At no time did Willard insist upon eliminating the trespass; on the contrary, Henderson was acceding to Willard's expressed desire that the house be completed and has consistently made his loan payments in full to Henderson although the gas pipeline continues to lie beneath his house. Although a letter from Henderson to First American reflects that Lone Star had made demand upon Willard to eliminate the trespass, there is no evidence that Lone Star had made such demand upon Henderson. The record is barren of any evidence of Henderson's evil intent or such disregard of Lone Star's or Willard's rights as may be deemed equivalent to evil intent toward them; in fact, Lone Star has never expressed any objection to Henderson's completion of the financing of the Willard house. Lone Star's Cross Point is overruled.

LIABILITY FOR ATTORNEYS' FEES

In its twentieth point of error, First American asserts that the trial court erred in awarding attorneys' fees to Lone Star.[6] Lone Star contends that its attorneys' fees are recoverable under its exemplary damage count, its Article

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[6] In its Corrected Judgment the trial court eliminated Henderson's joint and several liability for Lone Star's attorneys' fees.

21.21 of the Texas Insurance Code claim or as authorized by its Declaratory Judgment action on the validity of its easement. TEX. CIV. PRAC. & REM. CODE ANN. 37.009 (Vernon 1986). As we have held that no recovery should be allowed for either exemplary damages or insurance code violations, Lone Star must establish its claim for attorneys' fees by the Declaratory Judgment count.

Lone Star sought declaratory relief commencing with its original petition; the recovery of attorneys' fees, however, was not specifically pled in that count but was asserted in the prayer; a claim for attorneys' fees was also alleged in its insurance code violation pleading. In the pleadings upon which it went to trial, Lone Star sued for declaratory judgment relief and included general allegations seeking reasonable and necessary attorneys' fees in its prayer. Pleadings under the Declaratory Judgment Act are to be liberally construed. *Frost* v. *Sun Oil Co.*, 560 S.W.2d 467, 473 (Tex. App.—Houston [1st Dist.] 1977, no writ). There is no particular type of pleading required by the Act. *James* v. *Hitchcock Indep. School Dist.*, 742 S.W.2d 701, 704 (Tex. App.—Houston [1st Dist.] 1987, writ denied). We conclude that Lone Star's pleadings raised the claim for attorneys' fees under the Declaratory Judgment Act.

The jury and the judgment awarded Lone Star $45,000 as a reasonable fee for its necessary legal services in this case. There was no testimony allocating the fee among the counts, nor was there a division of the fee by the jury among the various theories of recovery in Lone Star's suit. No objection was made to the failure to segregate, and therefore the failure to segregate must be considered to be waived. *Hruska* v. *First State Bank of Deanville*, 747 S.W.2d 783, 785 (Tex. 1988); *Aero Energy, Inc.* v. *Circle C Drilling Co.*, 699 S.W.2d 821, 823 (Tex. 1985); *Matthews v. Candlewood Builders, Inc.*, 685 S.W.2d 649, 650 (Tex. 1985); TEX.R. CIV. P. 274.

The statute authorizes the granting of attorneys' fees in declaratory judgment actions upon the discretion of the trial court. TEX. CIV. PRAC. & REM.CODE ANN. § 37.009 (Vernon 1986); *Oake* v. *Collin County*, 692 S.W.2d 454, 455 (Tex. 1985). On appellate review, that portion of the trial court judgment concerning the granting or denial of attorneys' fees will not be reversed absent a clear showing of an abuse of discretion. *Ibid.* The abuse of discretion test is whether the trial court's ruling that attorneys' fees were recoverable was arbitrary or unreasonable. *Landry* v. *Travelers Insurance Company*, 458 S.W.2d 649, 651 (Tex. 1970). Here, the validity of Lone Star's easement, the subject of the declaratory judgment action, was the condition upon which all of Lone Star's claims were predicated. Under the circumstances, we cannot conclude that the trial court clearly abused its discretion by awarding the attorneys' fees as found by the jury. First American's twentieth point of error is overruled.[7]

COMMENCEMENT OF PREJUDGMENT INTEREST

First American's twenty-second point of error asserts that the trial court erroneously ordered prejudgment interest on both prevailing parties' damages to commence on the date the suit was filed rather than the date suit was filed against First American. The judgment provided that prejudgment interest would begin on August 8, 1989, the date the suit was first filed. Lone Star did not sue First American until October 2, 1991, whereas Willard filed his suit against First American on February 18, 1992.

Article 5069-1.05 § 6a of the TEX. REV. CIV. STAT. ANN. (Vernon Supp. 1996) provides that prejudgment interest accrues beginning on the 180th day after the date the defendant receives written notice of the claim or on the day

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[7] First American has not challenged Willard's attorneys' fees as found by the jury and awarded in the judgment to Willard.

the suit is filed, whichever occurs first. On December 2, 1988, Henderson gave written notice to First American of the claim because Lone Star had made written demand upon Willard to eliminate the trespass. The statute does not require that the notice be initiated by a specified party. We hold that First American had received written notice of the claims more than 180 days before prejudgment interest began to accrue on August 8, 1989, as per the judgment. Therefore, First American's twenty-second point of error is overruled.

Since we have disallowed Lone Star's recovery of additional damages under article 21.21 of the Texas Insurance Code, the issue of prejudgment interest on those damages is moot. Lone Star's cross point seeking such prejudgment interest is overruled.

LIABILITY FOR DTPA CLAIMS

The DTPA jury findings were favorable to Willard's recovery from First American. Because the trial court ruled that the jury damage findings pertaining to the Insurance Code violations were duplicative of the DTPA damage findings, it directed Willard to elect between these two theories of recovery. Willard chose the Insurance Code damage findings, and the judgment reflected that decision, specifically disregarding the jury findings to questions 17 and 18. The question presented is whether the DTPA damages are recoverable and may be substituted for the disallowed award under Article 21.21 of the Insurance Code. Other than the summary of each jury finding, there is no allusion to the DTPA claim in the judgment of the trial court. Although Willard in his appellate brief makes an abbreviated argument supportive of the jury's DTPA findings, he has not asserted a cross point seeking recovery under the abandoned DTPA theory nor sought the specific relief of reasserting the DTPA damage findings. He, however, is not required to urge this alternative ground of recovery until the appellate court has reversed the Insurance Code claim. *Boyce Iron Works* v. *S.W. Bell Telephone*, 747 S.W.2d 785, 787 (Tex. 1988); *Oak*

Park Townhouses v. *Brazosport Bank*, 851 S.W.2d 189, 190 (Tex. 1993). Inasmuch as the recovery under the Insurance Code has herein been reversed, to expeditiously determine the entire case, we will address Willard's DTPA claim.

The jury's affirmative answer to its Question 15 is the only predicate for the various DTPA findings. In Question 15 the jury found that First American had engaged in a "false, misleading, or deceptive act or practice" that was a producing cause of damages to Willard. In connection with this question, the court instructed the jury that the phrase "false, misleading, or deceptive act or practice" means that the company represented "that an agreement confers or involves rights that it did not have or involve." That jury instruction quoted subsection (12) of § 17.46(b) of the DTPA confirming that subsection (12) is the basis for the DTPA claims.

To be actionable under subsection (12), the misrepresentations must have been uttered with reference to the terms of the underlying contract between the parties. *Home Sav. Ass'n. Service* v. *Martinez*, 788 S.W.2d 52, 57 (Tex. App.—San Antonio 1990, writ denied). Here, the pertinent instrument was the interim construction binder. The only parties to the binder were the insurer, First American, and the insured, Henderson. There is no evidence of a contract between Willard and First American. It is undisputed that the parties to the insurance contract are First American and Henderson and that Henderson is the only title policy insured.

Likewise, there is no evidence of a statement by First American that might be construed as misrepresenting Willard's "rights, remedies, or obligations under the contract itself." The only statement or omission in the binder about which there has been any complaint is the absence of a coverage exception for the Lone Star easement from policy coverage. As stated, the absence of this exception in the binder is not an affirmative misrepresentation as to the easement. *Martinka*, 836 S.W.2d at 777. Furthermore, there

is no evidence that the binder was prepared or furnished for Willard's reliance or use or that First American had a duty to disclose the existence of an easement even to Henderson and clearly not to Willard, a non-party party to the contract.

We hold that for all the reasons stated there is no evidence to support the jury's answer to Question 15 that First American committed a false, misleading, or deceptive act or practice which was a producing cause of damage to Willard. First American's twenty-third point of error is sustained; therefore, it will not be necessary to address points twenty-four, twenty-five, twenty-six or twenty-seven.

The trial court's judgment that Lone Star recover $16,000 from Henderson, Willard and South Place is affirmed but reversed and remanded as to First American. The trial court judgment that Lone Star recover $45,000 in attorneys' fees from First American is affirmed. The trial court judgment that Lone Star recover 10% pre-judgment interest commencing August 8, 1989 from Willard, Henderson, First American and South Place is affirmed. The trial court judgment that Lone Star recover $25,000 exemplary damages and $50,000 additional damages from First American is reversed and rendered.

The trial court judgment that Willard recover its attorneys' fees from First American is affirmed. The trial court judgment that Willard recover 10% pre-judgment interest commencing August 8, 1989 from First American is affirmed as is the award of 10% interest on the judgment. The trial court judgment that Willard recover $150,000 actual damages and $300,000 for deceptive practices under the Insurance Code is reversed and rendered.

In all other respects the judgment of the trial court is affirmed.

TOM B. RAMEY, JR.
Chief Justice

Opinion delivered August 29, 1996
Panel consisted of Ramey, Jr., C.J., Holcomb, J., and Hadden, J.

PUBLISHED

APPENDIX K

Article 21.21(16) of the Texas Insurance Code, as amended, provides in pertinent part:

> Any person who has sustained actual damages caused by another's engaging in an act or practice declared in Section 4 to be unfair methods of competition or unfair or deceptive acts or practices in the business of insurance or in any practice specifically enumerate in a subdivision of Section 17.46(b), Business & Commerce Code, as an unlawful deceptive trade practice may maintain an action against the person or persons engaging in such acts or practices.

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Petitioner,

v.

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Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF MORTGAGE INSURANCE COMPANIES OF AMERICA IN SUPPORT OF THE PETITION

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---

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to S. Ct. Rule 37.2, Mortgage Insurance Companies of America ("MICA") moves for leave to file the attached brief amicus curiae in support of the petition. Petitioner has consented to the filing of this brief. Respondent has not consented, necessitating this motion.

MICA is the trade association representing the private mortgage guaranty insurance industry. Founded in 1973, MICA is composed of eight private mortgage guaranty insurance companies.[1] Collectively, MICA's members

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[1] These companies and their affiliates comprise the United States private mortgage guaranty insurance industry: Amerin Guaranty Corporation, Commonwealth Mortgage Assurance Co., General Electric Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Co., Republic Mort-

write all of the private mortgage guaranty insurance in the United States, insuring millions of mortgage loans and thousands of mortgage lenders and secondary market investors in real estate mortgages. The vast majority of these loans are purchased by such secondary mortgage market agencies as the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae").

MICA strives to promote a competitive and solvent mortgage guaranty insurance industry, which lends stability to insured lenders in the primary and investors in the secondary mortgage markets. MICA achieves this purpose by educating members and their insured lenders on legislative, regulatory and legal developments impacting the mortgage and mortgage guaranty insurance industries. MICA also serves as a liaison to housing trade organizations and other mortgage industry organizations.

MICA's members [2] believe that the issues presented in the decision below have broad implications for mortgage insurers, their insured lenders and investors in the secondary mortgage market.

The Fifth Circuit's conclusion below that the borrower is a third-party beneficiary of the mortgage guaranty insurance policy negatively impacts millions of insured loans and thousands of mortgage lenders nationwide, despite the fact that such holding is contrary to settled Texas law and that of other jurisdictions. This third-party beneficiary holding creates the exact conflict of interest between insurer and insured—the lender—that the Texas Supreme Court expressly sought to avoid in *Allstate Ins. Co. v.*

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gage Insurance Co., Triad Guaranty Insurance Corporation and United Guaranty Corporation.

[2] Although petitioner was a former member of MICA, GE Capital Mortgage Corporation acquired petitioner in 1993. Petitioner is no longer writing mortgage guaranty insurance and is no longer an active member of MICA.

Watson, 876 S.W.2d 145 (Tex. 1994). Ironically, the majority's *Erie* analysis below relies primarily upon, but misinterprets, *Allstate*.

The decision below illogically seeks to protect the borrower—the very *risk or hazard* against which the mortgage guaranty insurers' customers—the lenders—seek protection in obtaining mortgage insurance. That decision encourages borrower default by leading borrowers to conclude that they may assert provisions in the mortgage guaranty insurance policy to prevent the lender from taking a deficiency against them. This result is detrimental to insured lenders, insurers and the secondary mortgage market. Moreover, a practical effect of the opinion below may be to convert certain Texas borrowers' full recourse notes secured by first liens on real estate into "non-recourse" notes, dramatically reducing the borrowers' incentive to repay the insured mortgage. This reduced incentive increases the risk of borrower default, which weakens both the primary and secondary mortgage markets. Similarly, the decision will result in increased losses to mortgage lenders and insurers on each defaulted loan, since another effect of the Fifth Circuit's opinion is to impair the ability of lenders and their insurers to mitigate losses arising under the particular form of policy at issue in this case.

The Fifth Circuit's effort to reach a particular result by creating new state law is apparent in its opaque analysis under *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). The inaccuracy of the majority's "*Erie* guess" has now been confirmed by a recent intermediate Texas court decision, *First Am. Title Co. v. Willard*, No. 12-93-00290-CV, 1996 WL 495583 (Aug. 29, 1996). *Willard* reiterates settled Texas law that borrowers are not third-party beneficiaries with standing to sue the lender's insurer on the basis of the lender's insurance policy. This has been and remains Texas law, *unless*—as a result of the Fifth Circuit's holding in this case—the parties happen to be liti-

gating in federal court instead of Texas state court. If the decision below stands, the substantive law on this issue in a Texas federal court will be directly contrary to the law in a Texas state court. This result promotes confusion, forum shopping and exposes litigants to inconsistent results.

The practical consequences of the decision below greatly concern and affect the mortgage guaranty insurance and mortgage industries. Amicus is well acquainted with these industries, including primary and secondary markets for mortgage loans. Amicus can explain the negative effects of the Fifth Circuit's opinion on previously settled business and legal relationships between the mortgage insurer and its insured lender, on the one hand, and the *risk* that the lender insures against—*the borrower*—on the other.

For these reasons, MICA respectfully requests that the Court grant this motion for leave to file the attached brief amicus curiae.

Respectfully submitted,

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---

BRIEF AMICUS CURIAE OF MORTGAGE INSURANCE COMPANIES OF AMERICA IN SUPPORT OF THE PETITION

STATEMENT OF INTEREST OF AMICUS CURIAE

Founded twenty-three years ago, Mortgage Insurance Companies of America ("MICA") is a trade organization whose eight corporate members and their affiliates make up the active United States private mortgage guaranty insurance industry. MICA's member companies insure millions of mortgage loans and thousands of mortgage lenders and secondary mortgage market investors nationwide. MICA's purpose is primarily educational: informing members, the mortgage lending industry and housing trade organizations of relevant legislative, regulatory and legal changes. MICA also represents the mortgage guaranty insurance industry's position on Capitol Hill.

The purpose of mortgage insurance is to protect lenders from default-related losses on conventional first mortgages made to home buyers who make down payments of less than 20 percent of the purchase price. The roots of private mortgage guaranty insurance extend back to the late 1800's when the state of New York first passed legislation authorizing the insuring of mortgages. The modern private mortgage guaranty insurance industry dates from the 1950's.

The federal government entered the mortgage insurance business in 1934 with creation of the Federal Housing Administration ("FHA"). By guaranteeing full repayment to lenders if borrowers defaulted on their mortgages, the FHA program stimulated investor confidence in mortgage instruments and thereby encouraged growth of the housing markets. The FHA, Veterans Administration ("VA") and private mortgage guaranty insurers act in similar ways to protect lenders in case of borrower default. The FHA, VA and private mortgage guaranty insurers have played an important role in encouraging availability of affordable housing. Private mortgage guaranty insurance provides lenders an alternative means of insuring against borrower default. Availability of mortgage guaranty insurance to lenders plays a major role in facilitating the sale and marketability of residential mortgages to investors in the secondary market. The existence of that secondary market in turn supports expanded availability of mortgage financing necessary to further housing development.

Amicus is devoted to and has an interest in the strength and stability of the mortgage lending and mortgage guaranty insurance industries. As discussed more fully below, the Fifth Circuit's decision in this case—based on a misunderstanding of the limits *Erie* imposes under our federal system on the ability of a federal diversity court to create new state law—is not only legally incorrect, it also poses a serious threat to continued sta-

bility of the mortgage lending and mortgage guaranty insurance communities.

SUMMARY OF ARGUMENT

The Fifth Circuit's decision below violates the doctrine of *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), and principles of federalism underlying it, creates unmanageable legal inconsistencies and has numerous adverse consequences for mortgage lenders and mortgage guaranty insurers. These negative consequences derive from the fundamental flaw in the majority opinion, i.e., the new rule that the borrower is a third-party beneficiary of the lender's policy of mortgage insurance. This flaw results from the Fifth Circuit's disregard of established, consistent Texas law in its misguided and unrestrained *Erie* analysis. This Court should grant the petition to clarify appropriate standards for an *Erie* analysis in a case such as this, and the limits *Erie* places on the ability of a federal diversity court to create new state law. The Fifth Circuit's failure to recognize any such limits in this case resulted in a new rule of law with disruptive consequences for national commercial and public policy interests. These consequences, as discussed below, are yet another reason warranting this Court's review.

ARGUMENT

I. THIS COURT SHOULD GRANT CERTIORARI TO RESOLVE THE CONFLICT OVER WHETHER A FEDERAL DIVERSITY COURT MAY CREATE A NEW STATE CAUSE OF ACTION CONTRARY TO WELL-SETTLED STATE LAW AND COMMERCIAL PRACTICE.

Texas courts have consistently held that borrowers are not third-party beneficiaries of the private mortgage insurance contract between the lender and private mortgage insurer. See *Pineda v. PMI Mortgage Ins. Co.*, 843 S.W.2d 660 (Tex.App. 1992); *Shields v. Atlantic Fin. Mortgage Corp.*, 799 S.W.2d 441 (Tex.App. 1990); and

Hunt v. Jefferson Sav. & Loan Ass'n, 756 S.W.2d 762 (Tex.App. 1988), *cert. denied*, 489 U.S. 1079 (1989). Courts in other jurisdictions considering the issue have reached the same result.[1]

These state law decisions reflect the business reality that mortgage guaranty insurance is obtained by the lender to protect it from loss in the event the borrower defaults on the mortgage. The borrower is not the beneficiary of such a policy but the *risk or hazard* insured against. This is evident by the fact that mortgage insurers' underwriting to determine whether or not to insure a lender for a particular mortgage consists primarily of review of the potential borrower's creditworthiness, in order to determine the likelihood that the borrower may default, thus causing a loss to the insured lender and insurer.

Private mortgage guaranty insurance is an alternative to mortgage insurance provided by the FHA and VA. Like state decisions dealing with private mortgage guaranty insurance, federal decisions and legislative history pertaining to FHA insurance reflect that no legal relationship exists between the FHA [the insurer] and the borrower.[2]

Until the decision below, these reported decisions consistently defined the respective legal positions of the mortgage insurer, its insured lender and the borrower. The majority's radical departure from Texas and federal law injects chaos into these previously settled relationships. This chaos takes several forms.

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[1] See, e.g., *Twin City Fed. Sav. & Loan v. Zimmerman*, 411 N.W.2d 294 (Minn. Ct. App. 1987); *Key Pacific Mortgage, Inc. v. Industrial Indem. of Alaska*, 845 P.2d 1087 (Alaska 1993); and *Sandusky v. First Nat'l Bank of Sikeston*, 773 S.W.2d 95 (Ark. 1989).

[2] See *United States v. Neustadt*, 366 U.S. 696, 709 (1961); See also *DeRoo v. United States*, 12 Cl. Ct. 356 (1987) (no express or implied-in-fact contract existed between borrower and FHA, even where borrower allegedly relied upon FHA's issuance of conditional commitment of insurance).

The mo[illegible]ge guaranty insurance industry has never regarded the borrower as a third-party beneficiary of the insurance policy. This fact was before the trial court below in the form of expert testimony by Roger Blood, an experienced mortgage insurance consultant and commentator.[3] Mr. Blood explained:

> Based on my practical and personal experience with IMI [Investors Mortgage Insurance Company] and the mortgage insurance industry over the years, I know that the borrower is not recognized or treated as a beneficiary of the mortgage insurance policy. Mortgage insurance plainly and simply protects the lender against loss caused by the default of the borrower on the loan.

In holding that the borrower is a third-party beneficiary of the particular mortgage guaranty insurance policy at issue in this case, the Fifth Circuit has created a direct conflict of interest between the insurer's duties to its insured lender, on the one hand, and newly imposed duties to the borrower, on the other hand. Although the borrower is the lender's customer, the reality of those parties' relationship, as reflected in typical loan documents between them, is that the borrower is legally adverse to the lender. The lender is a creditor; the borrower is a debtor. The lender insures itself to protect against the borrower's default. The insurer's duties run logically and by commercial necessity to its insured, *not* to the party who is the *risk* insured *against*.

The legally adverse lender/borrower relationship is, for practical purposes, similar to the relationship between a first-party insured under an automobile liability policy and a third-party claimant to whom the first party insured may be liable. The Texas Supreme Court addressed the latter relationship in *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145 (Tex. 1994), and recognized that the insurer cannot

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[3] Mr. Blood's affidavit (Docket No. 81) was offered in support of petitioner's motion for partial summary judgment.

owe coextensive duties to its insured, on the one hand, and to the third-party claimant who is adverse to its insured, on the other hand.[4]

Similarly, the borrower's interest under mortgage guaranty policy provisions are directly adverse to the interest of the insured lender. For example, under typical policy provisions, including those in the policy at issue in this case, the lender has certain rights to file a claim and receive a claim payment, subject to policy conditions. In that regard, the lender is typically required to foreclose on and be in a position to deliver marketable title to the property to the insurer. These requirements directly conflict with the defaulted borrower's interests in avoiding a foreclosure and maintaining ownership and possession of the property.

Another example of conflict between the insured lender's interests and those of the defaulted borrower arises in the context of a pre-approved sale of the real estate. In mitigating loss, mortgage guaranty insurers are frequently asked by lenders to approve a sale of the secured property by the defaulted borrower to an approved buyer, in lieu of an actual foreclosure by the lender. Particularly in circumstances in which the market value of the secured property has declined since origination of the loan, the borrower is frequently requested to contribute cash toward the requested sale price. In these circumstances, the amount of the lender's loss and the amount the insurer

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[4] That court stated:

> Recognizing concomitant and coextensive duties under art. 21.21 [of the Texas Ins. Code] to third party claimants, parties adverse to the insured, necessarily compromise the duties the insurer owes to its insured. In fact, the logical result of permitting a separate and direct cause of action in favor of third party claimants allows third parties to sue for unfair claim settlement practices *even though the insured has no claim for an unfair claim settlement practice.*

876 S.W.2d at 150.

must pay the lender are directly affected by how much, if anything, the defaulted borrower is willing to contribute toward the pre-approved sales price in order to avoid a foreclosure. The more the borrower is willing to contribute, the smaller the lender's and insurer's losses will be as a result of the borrower's default. However, a defaulted borrower may perceive it to be in his or her best economic interest to contribute nothing, resulting in an increased loss to the lender. This example again reflects the legally adverse interests between the insured lender and the borrower by virtue of their creditor/debtor relationship.

Although the Fifth Circuit has held that the borrower is a third-party beneficiary of a particular policy, the court provides no guidance about the nature and extent of any alleged duties that the insurer may owe this purported beneficiary. For example, does the insurer have a duty to provide notice to the defaulted borrower of various aspects of processing the lender's claim under the policy? This and similar commercial and legal questions are not rhetorical, but will arise hundreds of times daily in operation of the mortgage lending and mortgage guaranty insurance industries if the decision below is left undisturbed.

The Texas Supreme Court expressly has refused to impose these conflicting duties on an insurer [5]; and yet, under the alleged rubric of *Allstate*, the Fifth Circuit has done

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[5] Subsequent to its holding in *Allstate*, the Texas Supreme Court also recently held in *Maryland Ins. Co. v. Head Indust. Coatings & Servs., Inc., et al.*, 40 Tex. Sup. Ct. J. 49 (Oct. 18, 1996) (*per curiam*) that an insurance carrier does not owe a duty of good faith and fair dealing to investigate and defend third party claims against its insured. Recognizing that an insured is protected against the insurer's refusal to defend or mishandling of a third-party claim by his contractual and other rights, the court concluded that imposing an additional duty of good faith and fair dealing on insurers is unnecessary and inappropriate. This opinion demonstrates that the Texas Supreme Court is *not* inclined to impose additional duties on an insurer, contrary to the Fifth Circuit's "*Erie* guess" in the *Palma* decision.

just the opposite. The illogical result is that the party legally adverse to the insured lender has now been given rights under the policy by the Fifth Circuit. This conclusion is legally and commercially untenable.

The Fifth Circuit's spontaneous creation of "new" Texas law results in mutually exclusive legal rules regarding the mortgage guaranty insurance contract. As petitioner discusses, Pet. at 20, Texas litigants now have two sets of inconsistent rules regarding the mortgage insurance contract: if the parties are in state court, the borrower is *not* a third-party beneficiary of the contract and has no standing under the Texas Insurance Code to sue the mortgage insurer; if the parties are in federal court, the contrary *Palma* rules would apply. This conflict exposes litigants to precisely the sort of inconsistent results that the proper application of *Erie* was designed to avoid. These conflicting rules also make it impossible for the lender and insurer to conform their business practices to consistent legal standards. Such conflicting rules create uncertainty among lenders, mortgage insurers and investors in the secondary mortgage market as to what rules apply to insured loans originated in Texas. The intolerable result is that the parties will only know which set of rules will *finally* apply once litigation ensues and the forum has been selected.

As petitioner demonstrates, division among the circuits as to how to apply *Erie* requires guidance and clarification from this Court. The decision below is a prime example of the unfortunate consequences of lack of judicial restraint on the part of federal diversity courts when it comes to creating new state law. The inaccuracy of the Fifth Circuit's "*Erie* guess" was confirmed when the Tyler, Texas Court of Appeals decided *First Am. Title Ins. Co. v. Willard*, No. 12-93-00290-CV, 1996 WL 495583 (Tex. App. August 29, 1996), holding that a mortgage borrower lacked standing to sue the lender's title insurer for a claim based on the title insurance policy. This result is entirely

consistent with Texas cases dealing with mortgage guaranty insurance, on which the industry has relied, but which the Fifth Circuit has rejected in its result-oriented decision.

Amicus has been advised that on November 5, 1996, the Fifth Circuit denied petitioner's motion for recall of the mandate and motions for leave to file a second petition for panel rehearing and a second suggestion for rehearing en banc. Petitioner had filed these motions to bring the intervening *Willard* decision to the attention of the Fifth Circuit, following the procedure adopted by petitioners in *Huddleston v. Dwyer,* 322 U.S. 232 (1944); *Exxon Co., U.S.A. v. Banque de Paris et des Pays-Bas,* 488 U.S. 920 (1988); and *National Union Fire Ins. Co. v. American Medical International, Inc.,* 116 S. Ct. 510 (1995). The Fifth Circuit's denial of the motions now places this case on all fours with *Huddleston, Exxon,* and *National Union.* In each of those cases, this Court granted certiorari, vacated the judgment below, and remanded for further consideration in light of the intervening state court decision. The Court should at the very least do the same here, if it is unwilling to grant certiorari to review the merits at this time.

The decision below also ignored other clear Texas precedent regarding the third-party beneficiary issue. Under Texas law, the intentions of the contracting parties [lender and mortgage guaranty insurer] control in determining whether or not the borrower is a third-party beneficiary. *See Corpus Christi Bank & Trust v. Smith,* 525 S.W.2d 501 (Tex. 1975). The law presumes that those parties contracted only for their own interests. Any doubt concerning whether or not the mortgage insurer and lender intended to benefit the borrower must be construed against the borrower as the alleged beneficiary. *See MJR Corp. v. B & B Vending Co.,* 760 S.W.2d 4, 8 (Tex.App. 1988).

Thus, the Fifth Circuit ignored settled Texas law pertaining not only to mortgage guaranty insurance in par-

ticular, but also the criteria for determining third-party beneficiary status in general.

II. THIS COURT SHOULD GRANT CERTIORARI BECAUSE THE FIFTH CIRCUIT'S OPINION ENCOURAGES BORROWER DEFAULT AND UNDERMINES STABILITY OF THE SECONDARY MARKET IN RESIDENTIAL MORTGAGES

As discussed on pages 5-8, bestowing third-party beneficiary status on the borrower will cause confusion generally in the relationship between the mortgage lender and the mortgage guaranty insurer. Allowing the borrower to interpret and enforce specific policy provisions also will lead to other results unintended by the lender and insurer and unexpected in the secondary market. For example, the Fifth Circuit adopted the borrower's argument pertaining to foreclosure bidding requirements in the policy and the assignment of deficiency rights by the lender. In so holding, the Fifth Circuit's decision effectively encourages borrower default, which will directly weaken the secondary mortgage market. If, as the Fifth Circuit has held, the borrower is a third-party beneficiary of this particular insurance policy and is entitled to enforce policy provisions, borrowers will likely believe that they can default without the threat of personal liability, to the detriment of the lender and insurer.

A. Increased Borrower Default

In the trial court, Palma argued that the lender was required by the particular mortgage guaranty insurance policy in question to bid the full amount due to the lender under the policy ("full-debt bid argument"). Taken to its logical end, this means that at the insistence of the borrower, the lender would be required to either forego or extinguish a deficiency by bidding the full amount of the debt at foreclosure.

The trial court rejected the "full-debt bid argument." The Fifth Circuit, however, appears to have adopted the argument by holding that the borrower had standing as a policy beneficiary to require the lender to bid either (1) the full amount of the balance due on the note, or (2) no less than twenty-five percent of the balance due on the note.[6] In addition to creating confusion regarding foreclosure bidding requirements, the decision below also confuses the borrower's role in relation to mortgage guaranty insurance.

In practical effect, the majority's opinion empowers the *borrower*—the party whose conduct is the *hazard* or *risk* insured *against*—to not only control the risk by deciding whether to pay, but also to avoid the consequences of her default by insisting that the lender extinguish any possible deficiency by bidding the full amount of the debt at foreclosure. This result conflicts with long-standing Texas law, under which lenders have the right to preserve and assert deficiencies after a borrower defaults on a purchase money mortgage.[7]

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[6] This holding is confusing and internally inconsistent. The Fifth Circuit provides no guidance as to whether or not the borrower can always insist that the lender bid the full amount of the debt or whether or under what circumstances the lender may bid less.

[7] See generally, Tex. Prop. Code Ann. § 51.002 (Vernon 1995); *Guerra v. Raymondville Bank of Texas*, 791 S.W.2d 212 (Tex. App. 1990); see also Tex. Prop. Code Ann. § 41.001(b)(1) (Vernon Supp. 1995). As further evidence that the borrower is not a third-party beneficiary of the mortgage insurance policy, the Texas legislature amended § 51.003 of the Tex. Prop. Code in 1991 to require a lender to credit the account of the borrower for any money received by the lender from a private mortgage guaranty insurer prior to the lender bringing an action for any deficiency owed by the borrower. The credit required by the statute specifically does not apply to the exercise by a private mortgage guaranty insurer of its subrogation rights against a borrower or other person liable for any deficiency.

Texas has made a determination that allowing deficiencies promotes an important policy by deterring borrower default. Without the possibility of personal liability for their mortgage obligations, defaulting borrowers have a distinctly reduced incentive to pay the mortgage which will likely lead to increased borrower default. As testimony before the trial court below demonstrated, an increase in borrower default will have a serious impact on the secondary mortgage market.

B. The Effect on the Secondary Market

By the mid-1980's, the residential mortgage market had become fragmented. Lenders who originated loans typically did not retain in their portfolio most of the loans they made. Instead, these originating lenders sold these loans into a national mortgage market,[8] often referred to as "the secondary market." The secondary market in residential mortgages is dominated by two large federally-created entities, Fannie Mae and Freddie Mac. Fannie Mae, a congressionally chartered, shareholder owned company, is the largest United States investor in residential mortgages and the largest issuer of securities after the U.S. Treasury. Generally, lenders require mortgage insurance when borrowers make down payments of less than 20 percent of the purchase price of a home because statutes establishing Fannie Mae and Freddie Mac provide that such entities must require mortgage insurance for such loans, unless the originating lender retains an interest of at least 10 percent in the mortgage or is contractually obligated to repurchase the mortgage if the borrower does not pay.[9]

Lenders and mortgage insurers know from experience that borrower attitudes about paying their mortgage directly affect stability of the secondary market. For ex-

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[8] Blood affidavit at 6.

[9] See 12 U.S.C. § 1454(a)(2) [Freddie Mac]; and 12 U.S.C. § 1717(b)(2) [Fannie Mae].

ample, by the mid-1980's, lenders and mortgage insurers recognized that a growing number of delinquent borrowers were able, but less than willing, to make their mortgage payments.[10] As a result, pursuit of deficiency judgments by lenders and mortgage insurers, where permissible, became even more important. The facts of this case illustrate the point. See Pet. at 4, 5.

Expert testimony before the trial court demonstrated the importance to lenders, investors in the secondary market and mortgage insurers of pursuing deficiencies. Caryl S. Bernstein, former General Counsel of Fannie Mae, testified that:

> Fannie Mae has a history of pursuing both owner/occupant and investor defaulting borrowers for the collection of deficiencies. Fannie Mae and other members of the lending community believed that the possibility of subjecting borrowers to deficiency judgments could operate as a significant deterrent to default. Additionally, the lending and mortgage insurance community realized that the recovery of deficiencies from borrowers, regardless of their occupancy status, was an effective loss mitigation technique.
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> The effect of Ms. Palma's [full debt bid] argument would be to transform the mortgage Note that she signed into a nonrecourse Note, when in fact, the Note was a full recourse Note. This result would not be in the best interest of lenders, including Fannie Mae, mortgage insurers, nor the public. Ms. Palma's approach would confer a special benefit upon people who make low down payments when purchasing homes [so that mortgage insurance would be required], while those who make higher down payments [so that mortgage insurance would not be required] would continue to be subject to deficiency judgments and otherwise be treated as having made

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[10] Blood affidavit at 7.

> full recourse Notes. *There can be no public policy reason for treating those who borrow a higher percentage of their home's value more favorably than those who put more of their own money into their homes.*[11] (emphasis added)

Ms. Bernstein further testified that pursuit of deficiency judgments contributes to the financial stability of lenders, mortgage insurers and taxpayers, especially when insured depository institutions are involved.[12]

C. Assignment of Deficiency Rights

The Fifth Circuit further componded its error of bestowing third-party beneficiary status on the borrower by adopting the borrower's interpretation of the policy. For example, the majority concludes that the assignment between petitioner and its insured lender is illegal. Contrary to the language of art. 21.21A of the Texas Insurance Code, an obscure provision with no relevant annotated case law, other Texas law and an attorney general's opinion permit an insurer and its insured to modify by agreement matters pertaining to the loss. See *Hartford Fire Ins. Co. v. Galveston, H. & S.A. Ry. Co.*, 239 S.W. 919 (Tex. 1922); and Texas Attorney General Opinion No. JM-218-1984.

Similarly, Ms. Bernstein testified that Fannie Mae regularly assigns its contractual rights to pursue borrowers to mortgage insurers and others, and believes it has the right to do so.[13] The Fifth Circuit's opinion thus impugns the practice of assignment of deficiency rights on insured residential loans originated in Texas, a practice widely

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[11] Docket No. 81 at 11. Ms. Bernstein's affidavit was before the trial court in support of petitioner's motion for partial summary judgment.

[12] *Id.* at 12.

[13] *Id.* at 9.

used in the secondary market to deter borrower defaults and mitigate losses.

Assignments of lenders' claims against defaulted borrowers are also widely used to pursue deficiencies arising out of loans insured by FHA. The National Housing Act expressly provides that the Secretary of Housing and Urban Development has the power to pursue claims against borrowers assigned by lenders. 12 U.S.C. § 1710 (g). To effectuate such power, the statute also requires that a lender who forecloses and takes possession of the mortgaged property after a borrower's default must assign to the Secretary "all claims of the mortgagee against the borrower . . ., arising out of the mortgage transaction or foreclosure proceedings. . . ." 12 U.S.C. § 1710(a). Assignment of claims against defaulted borrowers is thus a commonly used and important tool to discourage borrower default. The Fifth Circuit's pronouncement that such a practice is illegal is misguided and legally incorrect.

In its zeal to fashion new rights for the borrower, the Fifth Circuit's opinion reduces borrowers' incentives to pay their mortgages, creates untenable and conflicting rules of law and imposes conflicting duties on the insurer. All of these results are detrimental to the mortgage lending and mortgage guaranty insurance industries and ultimately to those persons seeking affordable housing.

CONCLUSION

For the foregoing reasons, and those in the petition, this Court should grant the petition and reverse the decision below; alternatively, this Court should grant the petition, vacate the judgment and either certify the state law question to the Texas Supreme Court or remand to the Fifth Circuit for further determination in light of an intervening Texas intermediate appellate decision.

Respectfully submitted,

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